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IRREVOCABLE TRUST

CAUTION:

The purposes of this memorandum are to assist you and the trustee of your irrevocable trust in:

1. Creating your irrevocable trust and transferring assets to the trust;
2. Setting up procedures to give required notices to beneficiaries;
3. Maintaining records for the trust; and
4. Filing any required tax returns.

This memorandum can only provide *general* information. If you or your trustee have any questions, please contact us.

INTRODUCTION

Part I of this memorandum discusses the documents that are required to create your irrevocable trust. The most important of those documents is the trust agreement, but there are other documents that must be signed and filed. The purpose of the trust is to receive gifts that qualify for the gift tax annual exclusion, and to avoid estate taxes being imposed on the trust assets at your death. To obtain this estate tax advantage, there are a number of formalities that must be observed, both in the creation of the trust and in the continuing administration of the trust.

Part II of this memorandum discusses the procedures that the trustee must observe in notifying the beneficiaries of their withdrawal rights. Such rights are granted to the beneficiaries to minimize the gift tax consequences of creating the trust. Part II also discusses the filing of any necessary fiduciary income tax returns.

PART I -- CREATING YOUR IRREVOCABLE TRUST

Trust Agreement

A separate summary was prepared outlining the terms of your irrevocable trust agreement. In general, the agreement tells the trustee how to administer the trust property. You cannot change the trust or any of its terms after it is executed and funded. It must be *irrevocable* in order to give you the advantage of not having the trust assets taxed in your estate at your death.

Trust Registration Statement

Because the trust is irrevocable, the trustee is required under Colorado law to register the trust with the district court of the county in which the “principal place of administration” is located. The principal place of administration is where the trustee usually keeps the records pertaining to the trust, such as the trustee’s usual place of business or the trustee’s residence. The purposes of the trust registration statement are to give the current beneficiaries notice of the creation of the trust, and to establish the court that has jurisdiction to hear any dispute concerning the trust.

If the trust is administered in Colorado, the trustee must sign a Trust Registration Statement and file it with the court. The filing fee is currently \$163. A copy of the Trust Registration Statement must be sent to each beneficiary. If the trustee is not located in Colorado, this form will not be used, and the law of the state where the trustee keeps the trust records will control any registration requirements.

Taxpayer Identification Number

Because an irrevocable trust is a separate entity for income tax purposes, the trust must obtain its own taxpayer identification number. We will apply for the number on the IRS website, and notify you of the number assigned to the trust. You should then use this number on any accounts opened in the name of the trust.

Transfer of Assets to the Trust

When you make cash gifts to the trust, you should simply write a check to the trustee of the trust, and have it deposited into the trust account. The account should be titled in the name of the trust, with the signers on the account being the trustee, or co-trustees, if applicable. If there are co-trustees, then they usually can delegate signing authority among themselves to avoid requiring all to sign every check.

Transfer of Property to the Trust, and Acquisition of Property by the Trust

In general, the donor should use this format for titling assets in the name of the charitable remainder trust:

The _____ [name of your trust], dated _____.

No property may be transferred to a charitable remainder *annuity* trust after the initial funding. Thus, the following discussion applies primarily to the initial transfer of property to an annuity trust, and any transfers to a unitrust.

Identification of Trustees

When the trustee acquires or sells property in the name of the trust, the trustee may be asked to provide evidence of who the trustees are, and who can sign for the trust. The donor or the trustee may, of course, provide a copy of the trust agreement to show that information. However, the donor may not want the trustee to disclose the entire trust agreement.

Usually an institution such as a bank or brokerage house will be satisfied with simply receiving copies of the first page, pertinent pages about trustee powers, and signature pages of the trust agreement, rather than the whole document. Alternatively, a Statement of Authority (discussed below for Real Estate) identifying the trustee can be provided to the companies.

Real Estate

Real estate can generally be transferred to the trust by signing and recording a deed. Colorado law allows real property to be titled in the name of the trust itself (without naming the trustee in the deed), as long as a Statement of Authority is also recorded in the real estate records to show the identity of the trustee(s). If there is a change of trustees, a new Statement of Authority should be recorded to reflect the change before the property is conveyed by the trustee.

Before you transfer any real estate to your trust, there are several special issues that you should consider:

- ◆ If the real estate is subject to any debt (that is, if there is a deed of trust or mortgage against the property), the note and deed of trust or mortgage documents should be

checked to see whether there are any restrictions on transferring the property. Those documents may contain a “due on transfer” clause, allowing the lender to accelerate the balance due on the loan if you transfer the property. In such a case, the donor should ask the lender if it will waive its right to accelerate the loan with respect to the transfer to your trust. If a waiver is obtained, be sure it is in writing. In addition, mortgaged real property could cause “unrelated business taxable income” as discussed in Part II.

- ◆ If you transfer real estate located in a state other than Colorado to the trust, you will have to comply with the real estate laws of the state where the property is located. An attorney in that state should be contacted about transferring the property.

Gift (and Generation-Skipping) Tax Considerations

Because the trust is irrevocable, any transfer of property to the trust by you is a completed gift. For example, when you transfer cash to the trustee, that cash is a gift from you to the trust beneficiaries.

By including withdrawal rights in the trust agreement (as discussed in Part II), the amount of the *taxable* gift can be reduced or even eliminated. However, if there are taxable gifts, then a gift tax return must be filed for each calendar year in which a gift is made. In addition, if you and your spouse want to elect “gift-splitting,” so that each gift made by either of you to a third party during a particular calendar year will be treated as made one-half by each of you, you must file gift tax returns in order to make the gift-splitting election. The gift tax return is made on IRS Form 709, is filed with the Internal Revenue Service, and is due by April 15 of the year following the calendar year in which the gift is made, although it can be extended to the same due date as your personal Form 1040.

Whether or not there are taxable gifts for gift tax purposes, you may want to consider filing a gift tax return to allocate a portion of your \$5,000,000 (in 2010 and 2011) generation-skipping tax (GST) exemption to the trust, if the trust includes generation-skipping provisions. (Generally, generation-skipping involves providing benefits to persons who are two or more generations younger than you, such as your grandchildren.)

If gift tax returns are required (to report taxable gifts, to make the gift-splitting election, and/or to allocate GST exemption to the trust), we recommend that you have your accountant prepare and file the returns. While we can prepare gift tax returns for you, we believe that it is usually more economical for your accountant to prepare and file those returns. Unless you make specific arrangements for us to prepare the returns, we will assume that your accountant will prepare and file all necessary gift tax returns. Please send us copies of any returns that are filed.

PART II - ADMINISTRATION OF THE TRUST DURING YOUR LIFETIME

Beneficiaries' Withdrawal Rights

As discussed above, whenever you transfer property to the trust, you will be making a gift to the trust beneficiaries. The gift tax law allows you to exclude the first \$13,000 (in 2010 and 2011) per year of gifts to each donee from your taxable gifts (and therefore not pay any gift tax or use any of your "unified credit" against gift and estate taxes). However, this "gift tax annual exclusion" only applies to a gift of a "present interest." A gift is a present interest if the donee has the immediate right to the use, possession or enjoyment of the gifted property. If the donee's rights to use, possess or enjoy the property are restricted, then the gift is a "future interest" and the gift tax annual exclusion does not apply.

If the trust simply provided that each contribution made by you would be retained by the trustee for investment and distribution to the beneficiaries at some time in the future, then all gifts to the trust would be future interests, and the gift tax annual exclusion could not be used. Your trust probably includes provisions to create present interests in the beneficiaries, and thereby make the gift tax annual exclusion available. Under those provisions, whenever you transfer property to the trust, certain beneficiaries may make withdrawals from the trust. These powers are referred to as "Crummey" powers, named after the court case involving similar powers. Usually, these withdrawal powers are structured so that you may specify which beneficiaries may make withdrawals, but if you do not specify otherwise, then your children (and perhaps your spouse) will have withdrawal rights. These withdrawal rights give the beneficiaries present interests, so that the gift tax annual exclusion will apply.

The withdrawal rights are limited in amount, and may only be exercised for a limited period of time after each contribution. The limitations are quite technical, and are spelled out in the trust agreement. In general, each withdrawal right is limited to make optimum use of the gift tax annual exclusion, without causing other tax problems. Although the annual exclusion is \$13,000 per donee per year, and in some cases may be doubled to \$26,000 per donee per year by electing "gift-splitting," there are other limitations that may apply, and which may limit a beneficiary's withdrawal power to \$5,000 per year. If you have any questions about how much gift tax annual exclusion may be available each year for gifts to your trust, please ask us.

The withdrawal power provisions are included to save gift and estate taxes for you and your family. You probably will not intend that a beneficiary will ever actually exercise a withdrawal power and take money out of the trust while you are alive. However, in order for the powers to be effective to create present interests, and make the gift tax annual exclusion available, the power holders must have real, legal rights to exercise the powers. Thus, you must be aware that the powers could be exercised by the holders.

In this regard, the IRS takes the position that the withdrawal powers will not work to create present interests unless the power holders have notice of the existence of the withdrawal powers and the contributions to the trust. We recommend that, when you create the trust, you give notice to the initial power holders that they have the powers, and of the initial contribution to the trust. If future contributions to the trust are fairly certain as to timing and amounts, the initial notice

could also list the planned future contributions. (However, additional notices should then be given of any change in who is entitled to make withdrawals, or in the future contributions as actually made.) The more conservative approach is for the trustee to give a new notice each time a contribution is made to the trust. We provided you with a form that can be used to provide notice to the beneficiaries of their withdrawal rights and of contributions to the trust. If you give us information about the initial contributions, we will prepare a notice of those contribution(s) that the trustee may send to the beneficiaries.

The trustee may use the blank form we will include with the copy of the trust to prepare future notices to the power holders. We can prepare those notices if the trustee wishes us to do so. However, unless the trustee makes specific arrangements for us to prepare the notices, we will not do so, and will assume that the trustee will prepare and deliver all future notices.

The completed notices should be delivered to the beneficiaries promptly after a contribution is made. We recommend that the trustee ask each beneficiary to sign a copy of the notice to acknowledge that he or she received it. The trustee should then keep those acknowledged copies of the notices as part of the trust's permanent records. The following is a discussion of the IRS's position on these notices and withdrawal rights:

The IRS has accepted the basic premise of the *Crummey* case, but has consistently taken the position that, to have a present interest, the beneficiary must have notice or actual knowledge of the existence of the Crummey power and of the gifts to the trust. We frequently help clients prepare initial notices to Crummey power beneficiaries which advise them of the power, the date and amount of the initial gift to the trust, and the dates and amounts of planned future gifts to the trust.

So long as the future gifts are actually made as indicated in the initial notice, we think this procedure adequately informs the beneficiaries and should satisfy any reasonable notice requirement. (If future gifts vary from the notice, then a new notice should be given. Also, if the initial notice is given to a parent or guardian for a minor beneficiary, it is advisable to give a new notice directly to the beneficiary when he or she reaches the age of majority.)

Income Tax Returns

The trust is required to file federal and state fiduciary income tax returns if the trust has a certain amount of income during a taxable year. The trust is required to use the calendar year as its taxable year. Currently, a trust is required to file income tax returns if, during a taxable year it has gross income of \$600 or more, or any amount of taxable income. If the trust is a "grantor trust," then the grantor reports all the income from the trust on the grantor's personal Form 1040, instead of reporting it on a trust income tax return. We recommend that the trustee retain an accountant to prepare those returns, or let us know if you would like us to prepare them.



IRS Circular 230 Notice: To ensure compliance with requirements imposed by the IRS, we inform you that any tax advice included in this written or electronic communication was not intended or written to be used, and it cannot be used by the taxpayer, for the purpose of avoiding any penalties that may be imposed on the taxpayer by any governmental taxing authority or agency.