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## **REVOCABLE LIVING TRUST**

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### **CAUTION:**

The purposes of this memorandum are to assist you in:

1. Transferring property to your revocable living trust (called "funding" the trust); and
2. Maintaining records for the trust and reporting income from assets held by the trust.

This memorandum only provides general information. If you have any questions, please contact us.

## **INTRODUCTION**

Part I of this memorandum discusses how to transfer assets from your own name to the name of your revocable living trust. Your revocable living trust is a "Will substitute;" that is, it is the document that determines who will receive your property after you die, and how and when they will receive it. The trust is also a tool to handle your assets if you become disabled. Along with your revocable living trust, you probably also signed a "pour-over" Will; a Will that essentially says that you leave your estate to the revocable living trust at the time of your death. In addition, you may have signed

a “durable power of attorney” in which you authorized someone else to transfer assets you own into the name of the trust.

Because of the pour-over Will and durable power of attorney, it is not absolutely essential for you to transfer title to your assets into the name of the trust right away. Instead, the trust could be a “stand-by” receptacle to receive your assets in the future. If you became disabled, the agent you named in your durable power of attorney could use the power of attorney to transfer assets into the trust, and your successor trustee would then manage the assets for your benefit. In addition, any assets you own at your death will be added to the trust under your pour-over Will.

There are, however, reasons why you probably want to transfer at least some of your assets to the trust right away. One of the reasons many people use a revocable living trust is to avoid probate. Property held in your revocable living trust at your death does not have to pass through probate. It is either retained in the trust, or distributed by the trustee, as provided in the trust agreement. However, your trust will successfully avoid probate only for assets that you transfer to the trust during your lifetime. Assets that you retain in your own name at the time of your death are subject to probate procedures, even though the assets may pass to the trust under your pour-over Will.

You should also understand that your trust can function effectively as a disability planning tool only if property can effectively be managed by your successor trustee in the event of your disability. As we said earlier, your durable power of attorney can allow your agent to transfer assets into the trust if you become disabled. Sometimes, however, institutions such as banks and brokerage houses are reluctant to accept durable powers of attorney that are not on the institution’s own form. Transferring assets to your trust yourself avoids this potential practical problem with the acceptance of a durable power of attorney.

As an alternative, you could sign an additional power of attorney for each bank, brokerage house, or other institution, using the institution’s own power of attorney form. You would then have your “master” power of attorney that we prepared for you, as well as a separate power of attorney for each bank, brokerage firm, etc. However, this approach could create problems if there are differences between the master power of attorney and one of the institution’s forms. Also, if you ever wanted to make a change (to name a different agent, for example), you would have to make the change with each institution, as well as changing the master power of attorney. Therefore, we generally don’t recommend this alternative unless there are other reasons not to go ahead and transfer assets to your trust.

We want to remind you that your trust is revocable by you. Thus, although “record” or public title to your assets may be transferred to the name of the trust, you will still control those assets.

If you wish, we can assist you in changing the titles of your assets to the name of the trust. If you change the titles yourself, and as you acquire new assets, it will be your responsibility to see that they are property titled. Different types of assets may need to be handled in different ways. Part I of this memorandum contains suggestions that should help you re-title your assets. These suggestions do not cover every type of property, however. You should, of course, feel free to call us to discuss any questions that arise.

Part II of this memorandum includes some general information about tax reporting. In general, during your lifetime, the trust is ignored for income tax purposes, and reporting of income is no different than when you owned your assets outright. However, if you are not one of the trustees, the trustee should send you a list of income received and deductible expenses paid. You should review Part II to understand the general rule. You (or your successor trustee) should call us or your accountant if you have questions.

## **PART I--FUNDING YOUR REVOCABLE LIVING TRUST**

### **General Form for Holding Title**

In general, you should use this format for titling assets in the name of your trust:

The \_\_\_\_\_ Trust, dated \_\_\_\_\_  
[Name of your trust]

In your trust agreement, the name of the trust will appear at the top of the first page, and also in article 2.

### **Identification of Trustees**

When you acquire or sell property in the name of your trust, you may be asked to provide evidence of who the trustees are, and who can sign for the trust. You may, of course, provide a copy of the trust agreement to show that information. However, you may not want 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 and signature pages of the trust agreement, rather than the whole document, and we would be happy to discuss that with them. You could also give them a copy of the Statement of Authority, which is a document that lists the name of the trust, the trustees' names and addresses, and who may act on behalf of the trust.

### **Real Estate**

Real estate can generally be transferred to your 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 trustees. Please let us know if you need a Statement of Authority, and we will be glad to provide one to you.

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. If the property is your residence, the lender might be prohibited by law from enforcing a due on transfer clause when you transfer the residence to your revocable trust, but you will want to check that *before* you make the transfer. If there is no exception available under the due on transfer clause, you might want to ask the lender if it will waive its right to accelerate the loan with respect to the transfer to your trust. If you do obtain a waiver, be sure it is in writing.

- ◆ If you and your spouse own real property as joint tenants with right of survivorship, it may be advisable to transfer the property to one or both of your trusts. However, you may first want to transfer title to only one spouse, and then to that spouse’s trust. You should discuss joint tenancy real estate with us before making a transfer.
- ◆ If you and your spouse own assets as “tenants by the entirety” in a state outside Colorado, changing title to that property may terminate any protection from creditors of only one spouse that such a manner of titling can provide in certain states (including Florida and Maryland, but also others).
- ◆ If you own real estate located in a state other than Colorado, it may be advisable to transfer that real estate to the trust, but you will have to comply with the real estate laws of the state where the property is located. Therefore, if you have real estate in another state that you want to transfer to your trust, please contact us.
- ◆ If you transfer real property to your revocable trust, you should add the trust to your homeowner’s insurance so that it will be treated as an additional insured. You should also request a rider to your title insurance policy so that the revocable trust will be included in the coverage, as owner of the property.

There are a number of technical issues relating to real estate titles. As a result, we generally recommend that you not try to handle transfers of real estate to your trust by yourself, but let us help you make those transfers.

## **Stocks and Bonds**

### **Stocks and Bonds Held in Brokerage Accounts**

If you have stocks or bonds that are not registered directly in your name, but are held for you by a brokerage firm (sometimes called a “street name account”), you do not need to transfer the individual stocks or bonds into your trust. Instead, you will simply need to transfer the brokerage account into your trust. Your broker will have his or her firm’s forms to do this, and can help you complete the forms. Of course, if you have any questions, please let us know.

## Registered Stocks or Bonds

If you deal regularly with a stock broker, he or she should be able to help you handle the paper work so that you can transfer stocks or bonds that are registered in your name into the name of the trust. However, if you do not have a broker who can help you do this, or simply wish to handle these transfers yourself, please ask us to provide you with forms to attach to the stock certificates to assign them to the trust.

As discussed in Part II, during your lifetime, all trust income will be reported directly on your personal income tax return, and the trust will not file an income tax return. Therefore, you should use your own Social Security Number as the trust's "tax identification number" on the stock or bond powers.

For publicly traded stocks or bonds, your signature on the assignments will need to be guaranteed. Your bank or brokerage firm can do that for you. A signature guarantee is not the same as a notary statement.

There may be buy-sell agreements or other restrictions on your right to transfer stocks or bonds, especially if the company is "closely held." If there are restrictions, it is often possible to obtain a waiver for a transfer to a revocable living trust. If you are uncertain whether there are any transfer restrictions, or if you want our help in asking for a waiver, please let us know.

## Life Insurance

In addition to your revocable living trust, you may have created an *irrevocable* trust to own insurance on your life and avoid estate taxation of the death benefit. Or, someone else, such as a child, may own insurance on your life, again in order to avoid estate taxation of the death benefit. If you have an irrevocable insurance trust, or if we have given you other instructions about your life insurance, this section does not apply to you. However, if you do not have an irrevocable life insurance trust and we have not given you other instructions, then we recommend that you make your life insurance payable to your *revocable* trust, as described below. (You should understand, however, that making your insurance payable to your revocable trust does *not* remove the death benefit from your estate for estate tax purposes. If you would like to discuss planning techniques that can be used to avoid estate taxation of life insurance death benefits, please let us know.)

Except as discussed in the preceding paragraph, life insurance on your life should be made payable directly to your revocable trust. You will need to obtain a new beneficiary designation form for each policy, from your agent or the appropriate insurance company. The beneficiary should then be changed to:

The then acting trustee of the \_\_\_\_\_ [name of your trust], dated \_\_\_\_\_, as amended.

An insurance company sometimes insists on using its own specialized format (which varies from company to company) for identifying a trust that is named as beneficiary of a life insurance policy. That is all right, as long as the trust is accurately identified. If your insurance company or agent

wants to use different wording from that given above, and if you have any concerns about whether the company's or agent's wording is sufficient, please contact us.

Sometimes, life insurance policies are not owned by the person whose life is insured. For example, life insurance on a husband's life may be owned by his wife, or vice versa. That type of ownership arrangement may well have made sense when the policy was obtained, but has no tax advantages under current law (assuming both spouses are U.S. citizens). In fact, that ownership arrangement can complicate the operation of an estate plan. Therefore, if there is any life insurance on your life that you think should be made payable to your revocable trust, but you are not the owner of the policy, please discuss this with us before proceeding. For those policies, it may be advisable to change the ownership of the policy as well as the beneficiary. Most insurance companies use a separate transfer or assignment form to change policy ownership, and you may have to request this form from your agent or the insurance company, along with the change of beneficiary form.

### **Individual Retirement Accounts, Pension, Profit Sharing and Other Retirement Plans, and Tax-Deferred Annuities**

If you have an Individual Retirement Account ("IRA"), you can name a beneficiary to receive any balance remaining in the account at your death. Similarly, if you participate in a pension, profit sharing, or other tax qualified retirement plan through your employer, the plan may provide a death benefit, for which you can name a beneficiary. In addition, the contracts for tax-deferred annuities usually permit the owner to name a beneficiary. All of these types of assets have income tax consequences to the beneficiaries, and in that way they are different from other assets. How you should handle IRAs, other types of retirement plans, or tax-deferred annuities may depend on whether you are married, the size of the account in relation to your other assets, and whether your children are adults. We will generally give you our suggested beneficiary designation language in the letter we send to you with copies of your signed documents. The following is a more general discussion of some of the issues involved.

If you are married, federal law requires that a surviving spouse receive a joint and survivor annuity from a qualified retirement plan death benefit (an ERISA plan), unless he or she consents to the naming of a different beneficiary. There are special rules that will have to be followed if you want to name your trust as beneficiary, instead of your husband or wife. Those restrictions do not apply to the beneficiaries named in IRAs or tax-deferred annuities.

There is usually a "trade-off" between estate tax benefits available if you name your trust as beneficiary (to fund the Family Trust with the "applicable exclusion amount," for example), and income tax benefits if you name your husband or wife as beneficiary. An IRA, retirement plan benefit or tax-deferred annuity is usually subject to income tax when received by the beneficiary (unless it represents money that you already paid income tax on, or investment in the annuity contract). In addition, your IRAs, retirement plan death benefits, and tax-deferred annuities are usually included in your estate for estate tax purposes. Therefore, these assets are potentially subject to *both* income taxation and estate taxation. (The beneficiary who has to pay the income tax has a special deduction for the estate tax attributable to the benefit, but the deduction does not completely offset the double tax effect.)

If you make your IRA, retirement plan death benefit, or tax-deferred annuity payable to your surviving spouse, it will usually qualify for the 100% estate tax marital deduction--deferring any estate tax until your spouse's later death. In addition, a surviving spouse has a special option to make a "spousal rollover"--the spouse can put the IRA or retirement plan benefit into an IRA and continue to defer the income tax on the benefit. For a tax-deferred annuity, the contract usually permits the spouse to simply become the new annuitant, and to continue to defer tax on the income earned within the annuity. Your spouse is required to begin taking minimum distributions out of a spousal rollover IRA beginning at age 70-½, just as you would have had to. Only a surviving spouse may make this spousal rollover election. Any other beneficiary, including your revocable trust, would have to pay income tax on the benefit as it is received.

A surviving spouse's ability to defer both the estate tax and the income tax on an IRA or retirement plan death benefit can be quite valuable. However, depending on the size of your and your spouse's estates, and how much of your estate is represented by the IRA or retirement plan benefits, there may be estate tax disadvantages to naming your spouse as the primary beneficiary. If you do not have enough assets other than the IRA, retirement benefits, or tax-deferred annuities to fully use your "applicable exclusion amount" against gift and estate taxes, paying the IRA, retirement benefit, or tax-deferred annuity to your spouse can waste your credit, and ultimately result in higher estate taxes for your family.

If your IRAs, retirement plan benefits and tax-deferred annuities do not constitute a large portion of your estate, and if your children are all adults, you may want to simply name your children individually as contingent beneficiaries (if you are married) or primary beneficiaries (if you are not married). Individuals may usually receive distributions of these types of benefits over their lifetimes, which results in a longer deferral of income taxes. The 2006 Pension Protection Act authorized non-spouse beneficiaries to transfer their share of retirement accounts to "inherited IRAs" and take them out over their own life expectancies.

In contrast, if a trust is named as beneficiary, it generally must receive full distribution of the account or benefit within five years after the date of death, so the income tax deferral is minimal. However, current regulations permit beneficiaries of trusts to be treated as the beneficiaries of a retirement plan (to use the beneficiaries' life expectancies to calculate the minimum distributions required) in certain circumstances. Four requirements must be met: (a) the trust must be valid under state law; (b) the trust must be irrevocable or will become irrevocable upon the death of the owner; (c) the beneficiaries of the trust must be identifiable; and (d) certain documentation must be provided to the plan administrator (a copy of the trust, or a list of beneficiaries with a certification that the list is complete and an agreement to provide a copy of the trust if the administrator asks for one). The documentation must be provided to the plan administrator either (i) at the time distributions are required to start, or (ii) within nine months after the death of the owner. If these requirements are met, then distributions may be made from the plan to the trust, using the beneficiaries' life expectancies, as provided in the regulations.

As a result of these complicated rules, the alternatives that should be considered for the beneficiary designations of IRAs, retirement plan death benefits, and tax-deferred annuities, include the following:

1. The spouse might be named as beneficiary, to take advantage of the estate tax marital deduction and the spousal rollover election for income tax purposes.

2. Your revocable trust might be named as beneficiary, to make sure that the IRAs or retirement plan benefits will be available, along with other assets, to fund the Family Trust and make full use of your unified credit (applicable exclusion amount) for estate tax purposes. To designate your revocable trust as beneficiary, use the following format (but see the discussion in alternative (6) below):

The then acting trustee of the \_\_\_\_\_ [name of your trust], dated \_\_\_\_\_, as amended.

3. Your spouse might be named as primary beneficiary, and the Family Trust created under your revocable trust as first contingent beneficiary. Under this alternative, your spouse can reevaluate the situation at the time of your death, and either (1) receive the IRA or retirement plan death benefit (and probably make a spousal rollover), or (2) disclaim all or part of the death benefit, so that it will pass to the Family Trust created under your revocable living trust, and avoid wasting your unified credit.

4. Instead of naming your spouse as primary beneficiary, you could name the Marital Trust created for your spouse's benefit as beneficiary. Special language must be added to the trust agreement if this alternative will be used. You may prefer this arrangement if you want to designate the disposition of the benefit after your spouse's death. In addition, you may use this alternative if the benefits constitute a large portion of your estate and the Marital Trust is a "qualified terminable interest property" (QTIP) trust. In that event, the unified credit or applicable exclusion amount can be used within the QTIP trust by the trustee not electing the entire trust to qualify for the estate tax marital deduction. To designate the Marital Trust as beneficiary, use the following format:

The then acting trustee of the Marital Trust created under the \_\_\_\_\_ [name of your trust], dated \_\_\_\_\_, as amended.

5. Instead of naming your revocable trust as primary or contingent beneficiary, you may want to name your adult children individually. To designate your children as beneficiaries (and to provide that a deceased child's share will be distributed to his or her children), use the following format:

My descendants, by representation, except that if any descendant is under the age of 18 years, his or her share shall be distributed to \_\_\_\_\_ as custodian under the UTMA for the benefit of that descendant.

6. However, if you do not want to make an outright gift of the account or benefits to your descendants, but still want the income tax deferral from calculating distributions based upon your descendants' life expectancies, you could designate the trusts created for your descendants under your revocable trust as the beneficiary. To have your descendants treated as "designated beneficiaries" of the trusts created for their benefit under your revocable trust, under the IRS regulations, use the following format (and provide the required information to the plan administrator):

The then acting trustee of the \_\_\_\_\_ [name of your trust], dated \_\_\_\_\_, as amended. If the trustee of the \_\_\_\_\_ [name of your trust] is directed to divide that trust into shares for the account owner/participant's descendants, this account shall be divided into separate shares for the account owner/participant's descendants in the same manner. Each share created for a descendant shall be payable to the trustee of the separate trust created for that descendant.”

Obviously, these rules are complex. Each situation must be separately evaluated. If you have not already done so, please discuss the beneficiary designation of your IRAs, retirement plan benefits, and tax-deferred annuities with us.

### **Bank Accounts and Certificates of Deposit**

Checking or savings accounts, or certificates of deposit, can be titled in the name of your trust. The ownership of a checking account is determined by the form of ownership as shown in the bank's records, not by the name or names printed on the checks. Therefore, you may want to change the title on the bank's records, to make your trust the owner of your checking account, but still have your individual name printed on the checks. That will not affect ownership of the account.

For bank accounts, you can change the title as soon as the trust is established. For certificates of deposit, you may want to wait until the certificates become due, and then renew them in the name of the trust.

In making changes to your bank accounts and CDs, you will want to be careful not to have more than the federal insurance limit (currently \$250,000) at any one financial institution. By using different types of titling, you can increase those limits at any particular bank. See [www.fdic.gov/deposit/deposits/dis/index.html](http://www.fdic.gov/deposit/deposits/dis/index.html) for additional information.

### **Automobiles**

Title to your automobiles could be placed in the trust. However, many people prefer to leave automobiles outside of the trust. Automobiles can usually be transferred without formal probate proceedings if the rest of the estate has been properly transferred to the trust.

If you do want to transfer an automobile to your trust, you should first check with your casualty insurance agent to make sure that this will not result in the insurance being subject to business, rather than personal, rates. To make the transfer, you will have to take the Title for the automobile to the motor vehicle office, and fill it out to reflect a transfer to the trust. Please contact us if you have any questions.

### **Tangible Personal Property**

You can transfer tangible personal property (such as jewelry, art, furniture, collections, etc.) to the trust by way of an Assignment. Under the Colorado Probate Code, you can keep a certain amount of property, other than real estate, in your own name and not have to have probate proceedings in

court at the time of your death. If the total of the assets remaining in your name at the time of your death is \$50,000 or less, and those assets do not include any real estate, then those assets can be transferred by affidavit (and without any proceedings in probate court). As a result, you may want to keep some of your tangible personal property outside of the trust. However, we recommend that any tangible personal property having a significant value (for example, valuable jewelry, art works, or collections) be transferred to the trust.

## **PART II--TAX MATTERS**

### **Income Taxes**

After you transfer your assets to your revocable living trust, the trust will be the legal owner of the assets. However, for income tax purposes, the trust is *not* treated as a separate taxpayer while you are alive and retain the right to revoke or change the trust.

The current IRS regulations provide that, during your life, the trust should not file any kind of income tax return. No income should be reported in the name of the trust. Instead, the income earned by any assets titled in the name of the trust will continue to be reported by you, individually. Your social security number should be reported as the tax identification number for the trust. If you are married, you may continue to file joint income tax returns with your husband or wife, and report the trust income on that joint return, just as you have probably been doing in the past.

If, during your lifetime, you cease to serve as one of the trustees of the trust, for whatever reason, then the income will still be reported on your return and under your social security number. The trustee is required to provide you with a list of income earned and deductions paid.

At your death, the trust will become irrevocable, and will thereafter be treated as a separate taxpayer for income tax purposes, unless it elects to be treated as part of the estate for income tax purposes. If the trust makes that election, income earned by the trust will be reported on the fiduciary income tax return filed by the estate. The trust will not need to obtain its own tax identification number, and file trust fiduciary income tax returns on IRS form 1041, until the later of two years after the date of death, or six months after the federal estate tax is finally determined. At that time, a new taxpayer identification number will have to be obtained for the trust. We generally recommend that an accountant be retained by the successor trustee to prepare income tax returns for the trust and the estate.

If you or your accountant have any questions about how to report income from assets held by the trust, please feel free to contact us.



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