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**IMPORTANT INFORMATION ABOUT
YOUR 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 may be 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, we prepared the Trust Registration Statement. After the trust is signed, the trustee must sign the Trust Registration Statement, and we will file it with the court. We will ask you for the filing fee of \$163. If the trustee is not located in Colorado, this form will not be used, and the law of the state where the trustee is located 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.

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.

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.

Bank Accounts and Certificates of Deposit

Checking or savings accounts, or certificates of deposit, can be titled in the name of your trust. 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.

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

- ◆ 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 federal 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 transfer you residence to an irrevocable trust, you will no longer be eligible for the senior property tax exemption, and you will lose the Colorado homestead exemption.
- ◆ 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 the irrevocable 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 irrevocable 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.

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.

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 generation-skipping tax (GST) exemption to the trust, if the trust includes generation-skipping provisions, or to “opt out” of the automatic allocation rules under the Internal Revenue Code. (Generally, generation-skipping involves providing benefits to persons who are two or more generations younger than you, such as your grandchildren.) We recommend that whether you want GST exemption to be allocated, or if you want to opt out of the automatic allocation, that a gift tax return be filed making that election, and providing that it will apply to all future contributions unless a later different election is made.

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), you may want to have your accountant prepare and file the 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 (such as a life insurance policy, or money with which the trustee will pay premiums for a life insurance policy), you will be making a gift to the trust beneficiaries. There may also be “imputed” gifts to the trust in certain circumstances. For example, if you transfer employer-provided group term insurance to the trust, each premium payment by your employer will result in a deemed gift from you to the trust.

The gift tax law allows you to exclude the first \$15,000 (in 2018) 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.

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 \$10 million (as indexed for inflation after 2011) generation-skipping tax (GST) exemption (indexed for inflation) 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 either have our office prepare them, or be sure to ask your accountant to send us copies before they are filed. 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.

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 \$15,000 (in 2018) 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 \$15,000 (in 2018) per donee per year, and in some cases may be doubled to \$30,000 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 addition, trust property subject to these powers may be subject to claims of the beneficiary’s creditors during the period in which it is exercisable.

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 included 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 make 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. The trustee will be required to file income tax returns to report trust income. We recommend that the trustee either retain an accountant to prepare those returns, or you should let us know if you would like us to prepare the returns. If the trust is a “grantor trust” then the grantor reports all trust income and deductions on his or her personal form 1040 instead of on trust income tax returns. We will discuss with you whether the trust is a grantor trust for income tax purposes.