

Understanding Funding Your Living Trust

Why and How to Transfer Your Assets To Your Revocable Living Trust

1. Creating a trust is the start of the trust procedure

These days many people choose a revocable living trust instead of relying on a will or joint ownership in their estate plan. They like the cost and time savings, plus the added control over assets that a living trust can provide.

For example, when properly prepared, a living trust will avoid the public, costly, and time-consuming court processes at death (probate) and incapacity (conservatorship or guardianship). It can let you provide for your spouse without disinheriting your children, which can be important in second marriages. It can save estate taxes. And it can protect inheritances for children and grandchildren from the courts, creditors, spouses, and irresponsible spending.

Still, many people make a major mistake that can render their trusts useless: they don't fund their trusts.

2. What is "funding" my trust?

Funding your trust is the process of transferring your assets from you to your trust. To do this, you physically change the titles of your assets from your individual name (or joint names, if married) to the trustee of your trust. You will also change most beneficiary designations to your trustee.

3. Who controls the assets in my trust?

The trustee you name for your living trust controls the assets in your trust. Most likely, you have named yourself as trustee, so you will still have complete control. Remember, one of the great features of a revocable living trust is that you can continue to buy and sell assets just as you do now. You can also remove assets from your living trust should you ever decide to do so.

4. Why is funding my trust so important?

If you have signed your living trust document but haven't changed titles and beneficiary designations, you've simply wasted your money. You may have a great trust, but until you fund it (transfer your assets to it), it doesn't control anything...because your living trust can only control the assets you put into it. And if the goal of your living trust is to avoid probate at death and court intervention at incapacity, then you must fund it now, while you are able to do so.

5. What happens if I forget to transfer an asset?

Your attorney will prepare a "pour over will" that acts as a safety net. When you die, the will "catches" the forgotten asset and sends it into your trust. The asset will probably have to go through probate first, but then it can be distributed according to the instructions in your trust.

6. Who is responsible for funding my trust?

You are ultimately responsible for making sure all of your appropriate assets are transferred to your trust.

7. Won't my attorney do this?

Typically, you will transfer some assets and your attorney will do some. Most attorneys will transfer your home for you, and will provide instructions for the rest of your assets. Often they will include sample letters or blank forms for you to use. Ideally, your attorney should review each asset with you, explain the procedure, and help you decide who will be responsible for transferring each asset. Once you understand the process, you will most likely decide to transfer many of your assets yourself and save on legal fees.

8. How difficult is the funding process?

It's not difficult, but it will take some time. Because living trusts are now so widely used, you should meet with little or no resistance when transferring your assets. For some assets, a short assignment document will be used. Others will require written instructions from you. Most can be handled by mail or telephone.

Some institutions will want to see proof that your trust exists. To satisfy them, your attorney will prepare what is often called a "certificate of trust." This is a shortened version of your trust that verifies your trust's existence, explains the powers given to the trustee, and identifies the successor trustees, but it does not reveal any information about your assets, your beneficiaries and their inheritances.

Even though the process is not difficult, it can be easy to get sidetracked or procrastinate. To prevent this from happening, make funding your living trust a priority and keep going until you're finished. Make a list of your assets, their values and locations; then start with your most valuable ones and work your way down. Remind yourself why you are doing this, and look forward to the peace of mind you'll have when the funding of your trust is complete.

9. Which assets should I put in my trust?

The general rule is that all of your assets should be in your trust. However, as we'll discuss later, there are a few you may not want in, or that cannot be put into, your living trust.

Generally, assets you do want in your trust include your home and other real estate, bank and saving accounts, investments, business interests and notes payable to you. You will also want to change most beneficiary designations to your trust so that those assets will flow into your trust and be included in your overall estate plan.

10. Will putting real estate in my trust cause any inconveniences?

In most cases, you will notice very little difference. You may even find it easy to transfer your home and other real estate to your living trust, and to purchase new real estate in the name of your trust. Refinancing may not be as easy. Some lending institutions require you to conduct the business in your personal name and then transfer the property to your trust. While this can be annoying, it is a minor inconvenience easily satisfied.

Because your living trust is revocable, transferring real estate to your trust should not disturb your current mortgage in any way. Even if the mortgage contains a "due on sale or transfer" clause, to retitle the property in the name of your trust should not activate the clause. There should be no effect on your property taxes because the transfer does not cause your property to be reappraised. Also, having your home in your trust will have no effect on your being able to use the capital gains tax exemption when you sell it.

Make sure your homeowners, liability and title insurance are all changed to reflect your trustee as the new owner.

11. What about out-of-state property?

If you own property in another state, transferring it to your living trust will prevent a conservatorship and/or probate in that state. Your attorney can contact a title company or an attorney in that state to handle the transfer for you.

12. What about contaminated property?

You can put contaminated property in your living trust, but the trustee can be held personally responsible for any clean up. If you are your own trustee, this won't affect you because you are already responsible. But if clean up is not complete by the time your successor trustee steps in, your successor (and, ultimately, your beneficiaries) can also be liable. If you suspect this may apply to you, tell your attorney before you transfer the property to your trust.

13. What about community property status?

Community property status can be continued inside your living trust. Also, if you live in a community property state, your attorney may suggest that jointly-owned assets, especially real estate, be retitled as community property before they are put in your living trust. This will reduce capital gains tax if the asset is sold after one spouse dies.

14. Should I put my life insurance in my trust?

That depends on the size of your estate. If you are single and your net estate (assets minus debts), including the death benefits from your life insurance, is less than \$1 million, or if you are married and your net estate is less than \$2 million, your estate will not have to pay estate taxes when you die. In this case, your living trust should be both the owner and beneficiary of your life insurance. This will give your trustee maximum control over the policies and proceeds.

If your estate is larger than this and you die before 2004, your estate will have to pay estate taxes. In this case, it would be better to set up a separate irrevocable life insurance trust and have it own your insurance policies. Because you would no longer own the insurance, it would not be included in your taxable estate. Reducing the size of your estate will reduce your estate taxes, and that will leave more for your loved ones.

There are some restrictions on transferring existing policies to an irrevocable life insurance trust. If you die within three years of the date of the transfer, it will be considered invalid by the IRS and the insurance will be included in your taxable estate. There may also be a gift tax. These restrictions do not apply to new policies purchased by the trustee of this trust. Be sure to discuss this with your attorney.

15. Should my trust own my car?

Unless the car is valuable and substantially increases your estate, you will probably not want it in your trust. The reason is this: if you are at fault in an auto accident and the injured party sees that your car is owned by a trust, they may think "deep pocket" and be more likely to sue you.

Every state allows a nominal amount of assets to transfer without probate. If the value of your car falls within this amount, you are probably okay. Some states let you name a beneficiary for your car, which avoids probate and works well. Your attorney will know the procedures and laws in your state and will be able to advise you.

16. What about my IRA and other tax-deferred plans?

You cannot change the ownership of these to your living trust. You can name your living trust as the beneficiary, but be sure to consider all your options. These include your spouse, if you are married; your children, grandchildren or other individuals; a trust; a charity; or a combination.

Whom you name as beneficiary of these plans will have a significant impact on the amount of tax-deferred growth this money can continue to earn after you die.

If you are married, your spouse is probably your best option because if you die first 1) the money would be readily available to your spouse and 2) it gives you the spousal rollover option. (After you die, your spouse can “roll over” your tax-deferred account into his/her own IRA and name a new beneficiary, preferably someone much younger, as your children and/or grandchildren would be.)

Of course, any time you name an individual as beneficiary, you lose control. After you die, the beneficiary can do whatever he or she wants with this money, including cashing out the account and destroying your carefully made plans for long-term, tax-deferred growth. The money could also be available to creditors, spouses and ex-spouses. And there is the risk of court interference at incapacity.

Naming a trust as beneficiary will give you maximum control over the money because the distributions will be paid not to an individual, but into a trust that contains your written instructions stating who will receive this money and when. After you die, the distributions will be based on the life expectancy of the oldest beneficiary of the trust. The trust must also meet certain legal requirements, which most living trusts now do.

The rules for these plans have recently been made simpler, but they can still be confusing, and it is easy to make a mistake that will prove costly to loved ones. Because there is often a lot of money at risk, be sure to get expert advice.

17. Are there any assets I should not put in my trust?

If you live in a noncommunity property state and have owned an asset jointly with your spouse since before 1976, transferring the asset to your living trust could cause your surviving spouse to pay more in capital gains tax if he or she decides to sell the asset after you die.

If the asset is your personal residence, this would not be a problem unless the gain is more than \$500,000. But it could be a problem for other assets like farmland, commercial real estate or stocks. If this sounds like it could apply to your situation, check with your tax advisor or attorney before you change the title to your living trust.

Other assets that should probably not be transferred to your trust are incentive stock options, Section 1244 stock and professional corporations. If you are unsure whether or not to transfer an asset to your trust, check with your attorney.

18. What about property that doesn't have a title?

Personal property like artwork, clothing, jewelry, cameras, sporting equipment, books and other household goods typically does not have a formal title. Your attorney will prepare an assignment to transfer these items to your trust.

19. What if I buy new assets after I fund my trust?

Find out if you can take the title initially as trustee of your trust. If not, transfer the title right away. If you're not sure how to transfer it, contact your attorney.

20. Funding Your Living Trust (Summary)

Assets You Probably Want in Your Living Trust

- Real property (home, land, other real estate)
- Bank/credit union accounts, safe deposit boxes
- Investments (CDs, stocks, mutual funds, etc.)
- Notes payable (money owed to you)
- Life insurance (or use irrevocable trust)
- Business interests, intellectual property
- Oil and gas interests, foreign assets
- Personal untitled property

Assets You May Not Want in Your Living Trust

- IRA and other tax-deferred retirement accounts
- Incentive stock options
- Section 1244 stock
- Interests in professional corporations