



A Married Person's Guide to Using a Funded Revocable Trust to Reduce Estate Tax and Avoid Probate

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A. The Role of the Revocable Trust in the Two-Part Estate Plan. An important purpose of “estate planning” is to arrange property ownership and its deathtime distribution to avoid or reduce administration costs, such as those associated with probate, and taxes that otherwise would be due upon your death. One popular way to do this is through a two-part plan involving a “*pour-over will*” and a “*revocable trust*”. The will plays the secondary role of transferring – “pouring over” – any probate assets into your revocable trust upon your death. The trust, and not the will, is your primary vehicle: it will determine how, and to whom, your property is to be distributed on your death. It handles things like gifts to charity, specific gifts to specific persons, the creation of further trusts for minor or disabled children or other beneficiaries, etc. This is why the revocable trust is sometimes referred to as a “will substitute.”

If you instruct your attorney to prepare wills and trusts for you, you may assume that you have completed your probate avoidance plan when you sign the documents. In fact, however, your job is then only part way done. You must still focus on considering what property ownership rearrangements might be necessary to complete the project. A failure to follow through on this second step and to complete the necessary funding of the trusts may negate many or all of your planning objectives. It might be likened to buying a car but forgetting to put any gas in it. The “gas” that will fuel the revocable trust-centered estate plan is the lifetime funding of the trusts. Funding can achieve two important purposes. *First, funding avoids probate administration and all of its costs, delays and publicity. Second, funding will assist your family members and others easily to identify, assemble and administer your assets upon your death.* The following will

elaborate on these benefits and provide some guidance on how to fund your trust to achieve them.

1. *The Funded Revocable Trust Will Help Avoid Probate*

Administration. Planning to avoid or reduce the unpleasant aspects of probate administration is often cited as one of the primary benefits of revocable trusts. Probate is the court procedure that oversees the administration of much of the property (“estate”) of deceased and incompetent persons¹. For example, upon your death, the probate court appoints the executor named in your will to be responsible for making an inventory of your assets, paying your outstanding debts at death and then distributing the assets remaining in your estate in accordance with your will.

The entire process can be costly, time-consuming and public². Fortunately, your family need not suffer from the benign neglect of our policy makers. Probate is voluntary, self-inflicted pain. If you change title to your assets to your revocable trusts during your lifetime, then upon your death or incapacity³ the successor trustee appointed under the trust has authority to manage and distribute your assets in accordance with the terms of the trust. Since the assets do not pass into your estate, there is no need for probate. You avoid all of the costs, delays, and publicity. The trustee named in your trust has the fiduciary duty to manage and distribute trust assets in accordance with the trust terms. There is currently no direct probate court supervision of this process. Nor is there likely to be any in the future.⁴

2. *The Funded Revocable Trust Will Help Avoid Problems With the*

Identification of Assets. Funding the trust during your lifetime can also make it easier for your family in the event of your incompetency and upon your death. Your assets will all be readily identifiable in the trust name. Having an inventory of the assets will allow your successor trustee immediately to step in and manage the trust property without the delays that might otherwise occur if he or she were forced to identify and assemble them. This asset identification and inventorying process accounts for much of the delay, expense and inconvenience of probate.

B. *How Do I Fund The Trust?* You must first decide how your assets are to be divided between you and your spouse’s trusts to achieve the objectives described above. Then you are ready to fund. In order to do this, it is necessary for you and your

spouse to change the title of your assets into the name of the trust. You should consider the following when retitling your assets:

1. Real Estate.

(a) In General. Normally, your attorney will prepare deeds and the necessary documents for you to transfer your real estate interests into your revocable trust. You should provide your attorney with photocopies of your recorded deeds along with instructions as to which revocable trust (your or your spouse's) you would like your property transferred into.

(b) Mortgaged Real Estate. If you are considering transferring mortgaged real estate into your trust you may have to first contact and receive the prior written consent of the mortgage holder. This may mean contacting each bank and reviewing the transfer with them. (Note, however, that under a recently enacted federal law this may not be required and you may be able to simply to inform the bank of the change of title after it occurs. We can consult with you to determine whether this option is available to you). Some banks charge an administrative fee and legal fees to review the request and process the change of title, while others have different requirements that you must meet before they approve the transfer.

Be aware that many mortgages are sold on the secondary market and are subject to the policies of *Fannie Mae (FNMA)* or *Freddie Mac (FHLMC)*. These agencies establish certain requirements of transfers into revocable trusts. The major requirements you must meet are that the borrower must be an occupant of the property and the beneficiary of the revocable trust to which the property is transferred. Otherwise, you may find the bank will not approve the transfer.

(c) Out-of-State Real Estate. If you own real estate outside your state of domicile, it may be particularly important to transfer it to your revocable trust. This will avoid the need after your death to hire an attorney in the other state to conduct “*ancillary*” probate of the property. This will often lead to even more expense and delay. Your estate-planning attorney will probably work with legal counsel in the other state to review and prepare the necessary documents for the transfer. This will result in additional legal fees - but probably much less than an out-of-state probate administration would have cost.

(d) **Owner's Title Insurance.** If you have owner's title insurance (as opposed to title insurance that you purchase for the lender), you may lose the benefits of the insurance when you transfer the property to your revocable trust. It may be advisable to transfer the property via a warranty deed (as opposed to a quitclaim deed) or to purchase an additional insurance rider. You should discuss this with us and give us a copy of the title insurance policy.

2. **Stocks and Securities.**

(a) **Publicly Traded Securities.** Securities held in "street name" in your brokerage account are easily transferred. Contact your stockbroker with instructions to transfer the account into your revocable trust. You will find that most brokers are familiar with this simple process and will prepare the necessary paperwork for you. Also consider accomplishing the more difficult task of transferring any original stock certificates that you do not hold in stock brokerage accounts. Many attorneys will help you handle this cumbersome process (including the preparation and delivery of transfer instructions, stock powers with signature guarantees, trustee's certificates, etc.).

(b) **Family Businesses.** You can easily transfer your interests in "closely held" businesses by having your corporate or estate planning attorney prepare some simple corporate legal documents.

Beware:

i. **Your stock of a closely held corporation may be classified as an S (also called a "subchapter S") corporation for federal income tax purposes.** The S corporation rules strictly limit the types of trusts that can hold the stock an S corporation without jeopardizing its continued S corporation status. Your revocable trust is an eligible shareholder for as long as you are living. But upon your death, it might not continue as such for long unless your attorney makes special provisions for stock in your revocable trust. Be sure to discuss this with your attorney: the income tax consequences of an inadvertent S corporation disqualification can be severe.

ii. **Stock of professional associations and corporations, and professional limited liability companies.** If you are a professional doing business in the corporate form as a "P.A.", or as a professional limited liability company (a "PLLC"), be aware that your state's law may prohibit trust ownership of the

stock of a Professional Association. If that is the case *do not* transfer it to your revocable trust.

3. *Tangible Personal Property.* Transfer your unregistered “tangible” personal property (household effects, antiques, jewelry, furs, classic automobiles, boats, etc.) into your trust by signing a Deed of Gift or Transfer that your attorney can easily prepare. There is no requirement that this deed provide a detailed listing of these tangibles; however, it may be a good idea to do so to provide an inventory (and perhaps a memo describing your desired distribution of the tangibles) to allow for their easy identification and distribution after your death. Separately transfer vehicles and all other personal property that have certificates of title. Consider the convenience of re-titling vehicles into the name of your revocable trust upon renewal of your registration.

4. *Certificates of Deposit and Bank Accounts.* Begin splitting any joint bank accounts that you own into the names of your respective revocable trusts. Some banks will allow you to retitle a CD into your individual name, or in the name of your trust before maturity, without penalty. You may find it easier to retitle CDs upon maturity; you can change your checking and savings accounts at any time. The tax identification number of your revocable trust will be your social security number.

5. *IRAs and Tax Qualified Retirement Plans.* For married persons owning IRAs, SEP, 401(k) plan assets and other qualified pension and profit sharing funds, it is often prudent planning to name the spouse as the primary beneficiary, and your children as your secondary beneficiaries, with both the spouse and children having the power to disclaim the interest if income tax planning considerations warrant it. Having individual beneficiaries - and not your trust - succeed to a substantial retirement account balance might allow them the flexibility to continue the growth of the plan balance in an income tax sheltered solution for a significant period of time after your death. This flexibility might be reduced if the trust is the designated beneficiary.

Beware: If you are interested in naming someone other than your spouse as the primary beneficiary, the tax law may require your spouse first to waive certain rights he or she is given under federal law. Other technical rules in this area are complex and there are several traps for the unwary. Discuss these issues with us.

6. ***Insured Property.*** Contact your insurance carriers if you are considering transferring insured property (most notably automobiles and real estate) into your revocable trust. Be certain that any individuals who “use” the property owned by the revocable trust are named as an “insured” on the property’s insurance policy with the revocable trust named as an additional insured. Confirm with your insurance agent that revocable trust ownership will not result in higher premiums under some fine print in the policy.

7. ***Life Insurance Policies and Annuities.*** Obtain change of beneficiary forms for any insurance policies and annuities from your insurance agent or directly from the insurance company. For life insurance policies your revocable trust normally is designated as the primary beneficiary with designated individuals as the contingent beneficiaries. For annuities, the rules become complex. Designating your revocable trust as annuity owner may jeopardize the income tax deferred status of the annuity. Work with your insurance agent and direct him or her to change the beneficiary of your policies.

C. ***What If Some Stranger Asks for a Copy of My Trust?*** When transferring your properties into your trust, you may encounter requests from banks and other companies including stock brokerage firms, stock transfer agents, mutual fund companies, etc., for a copy of the complete trust. They might insist that their in-house legal department needs to review it. They don’t. It will usually suffice for you to give them a copy of the first page identifying the date you signed the trust, and the signature page showing that the trust was validly executed and notarized. There is no reason for them to see those parts of the trust that contain sensitive, personal information about how your property is to be distributed upon your death. This keeps the terms of the trust document private – one of the important advantages of having a revocable trust and avoiding probate. Some of these people may ask for a certified and attested copy of the date and signature pages of your trust. Let us know and we can provide the appropriate certification and attestation.

D. ***Final Word: By Funding My Trust, Have I Created a Monster?*** No! Many people worry that by funding their trust during their lifetime they are irrevocably transferring their property or losing control over it. Nothing can be farther from the truth.

Such people are confusing “irrevocable” living trusts with “revocable” living trusts. Funding an irrevocable trust requires you to sacrifice the use and enjoyment of the property you transfer to it. By contrast, your funded revocable trust is a “paper tiger” throughout your lifetime. You remain the captain of the ship: you retain absolute power to amend or revoke your trust, and may move property in and out of the trust at any time. You continue as the ultimate owner of the property through the trust. You need not obtain from the IRS a separate taxpayer identification number for the trust. Your trust identification number is your Social Security number. This eliminates any need to file any separate trust tax return. You report all items of trust income and capital gain on your Form 1040 as if you received it directly.

Although retaining all of this flexibility and control is a good thing, note that since you have complete access to the trust, it will not insulate your assets from your creditors. Furthermore, the trust will not protect funds in the event of catastrophic occurrences, such as lawsuits or long-term nursing home care. And, all assets in your revocable trust will be subject to federal estate taxation upon your death.⁵ You just can't have your cake and eat it, too.

Feel free to call us if you encounter any difficulties or if you have any questions about funding your trust.

Endnotes

¹ Some people ask us, “Why is there probate if it’s so bad?” We tell them that it’s a vestige from a bygone era. It has outlasted its usefulness. In the old days, it may have been necessary to provide for the probate judge’s close supervision, and detailed inventory and accounting procedures, to protect beneficiaries and creditors from overreaching, dishonest executors. You can provide essentially the same safeguards in a revocable trust. But they have only been popular for the past thirty years or so. Sometimes it takes a while for the law to catch up with the times.

² Cost. Probate costs can average between one and five percent of the value of the probate assets. In New Hampshire, attorney’s and other fees can run as high as \$3,000 to \$5,000 for a \$100,000 estate, and \$10,000 to \$30,000, sometimes more, for a probate estate valued at \$1 million.

Time consumption and delays. Probate estates in New Hampshire must generally remain open for a minimum of 6 months. The executor may make no distributions to beneficiaries until this period expires. If the estate is significant (over \$5.34 million in value for a death in 2014) and an estate tax return is filed, the period of probate administration can be two years or more. The executor has very little latitude to distribute property during the period ending with the expiration of the initial six-month period, and ending with the closure of the estate. Things like will contests and contested creditor’s claims can further delay distribution.

Publicity. Your will and the inventory of your estate’s assets are part of the public probate record that is available for inspection. Anyone who wishes to know the nature and extent of your property and who receives it can simply go to the probate court and request a review of your probate file. Natalie Wood’s estate passed through probate. Anyone interested can visit the Los Angeles probate court and learn that she had a \$6 million estate that included 29 fur coats. Bing Crosby left a funded revocable trust. You cannot find any public details about his estate or about how “Daddy Dearest” treated his offspring. New Hampshire probate is needlessly so. In recent years we have made some modest changes to make the process more user-friendly, but have for the most part resisted the modern trend that rejects arcane, complex probate laws and procedures for a more streamlined “easy in/easy out” approach.

³ The probate court can also come into play if you become incapacitated and unable to manage your property. If this happens, and you have not funded a revocable trust or signed a “durable” power of attorney, your loved ones must seek authority from the probate court to manage your property. Your assets are frozen until someone can be appointed as your “guardian” for this purpose. He or she must bring a petition and convince a probate judge that your recent behavior endangers your own personal and property interests. Obviously, producing this evidence in a public forum can be embarrassing for you and the family. Consider what happened to Groucho Marx in his waning days in the 1960s. The efforts of his companion, Erin Fleming, to have herself appointed as his guardian over the objections of Groucho’s family turned into a media circus widely reported in the tabloids and even the prestige media. If Groucho had a funded revocable trust designating Erin as his successor trustee, she could have automatically succeeded Groucho to manage the trust property only after satisfying minimal requirements Groucho set forth, such as obtaining the written certification from designated medical doctors that Groucho was incompetent.

⁴ Will an unfunded revocable trust afford you any protection from the probate process? Yes, to a limited extent. Recall that in a two-part plan, your will directs your executor to distribute your probate

property to your revocable trust. Your executor will be subject to the probate court's jurisdiction until this process is complete. However, once the probate of the estate is completed, and assets are placed in the trust, the trust might continue in existence for the benefit of your beneficiaries for a period after your death. The trustee of this ongoing trust will not be subject to the continuing supervision of the probate judge. This is to be favorably contrasted with a situation such as a continuing trust created under a will. In New Hampshire, the trustee of such a "testamentary trust" must file with the probate judge an initial inventory of the trust assets. Thereafter, the trustee must file annual accountings detailing things like income earned and paid out, expenses, etc. incurred during the year. You obtain these benefits of continued probate avoidance with a funded revocable trust as well.

⁵ The appreciated assets in the revocable trust will enjoy a "step-up" in their federal income tax cost basis, allowing your beneficiaries later to sell the asset with little or no federal capital gain tax liability.