

LIVING TRUST

OPERATING GUIDE

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This document is for informational purposes only. Any changes in federal or state laws may invalidate the information contained herein. It is your responsibility to follow the directions herein to avail of all benefits provided by a Living Trust. If you do not, then adverse consequences will apply.

CHAPTER 1.

GENERAL INFORMATION

INTRODUCTION

It is vital that the grantors read this guide to gain a better understanding of how a Living Trust should be set up and operated. There is a great deal to know about setup and operation, and this manual is the best source to get the information from. This manual was written to provide the trust grantors most of the guidance that is necessary to gain the benefits that the grantors want from their trust.

Signing and notarizing the trust documents are important, but in order to obtain the benefits of the trust, it is absolutely imperative that the trust grantors transfer their assets into the trust (fund the trust). Only by funding the trust can the grantors' estate avoid probate, preserve the estate tax exemption of the first grantor to die, and receive all the other benefits that the trust can provide.

Overview. Generally, the Living Trust offers:

1. Probate avoidance.
2. Prevention of outside spouses from taking over estate property after the death of the first spouse,
3. Management and are taking care of the estate should the grantors become incapacitated and preservation of both estate tax exemptions of a grantor-married couple,
4. An estate exemption based upon the current IRS regulation of the first spouse to die (A-B provision of the trust).

Trustee Arrangements. In most cases, the grantors will start out as the trustee of their trust, though that may be changed at any time. Also in most cases, the grantors select one or two of their heirs, who are usually secondary beneficiaries of the trust, to act as successor trustee. The successor trustee takes over the trust when the grantors either become mentally incapacitate or when they die.

Revocability and Amendability. The Living Trust is designed so that the grantors retain the ability to either revoke or to amend the trust in any way, as many times as they wish.

Tax Status and Classification. The Living Trust is classified under federal tax law as a "grantor trust". This means that all tax activities remain unchanged for the grantors. Any income from trust property will be reported on the grantors' tax return. Any capital gains or depreciation will accrue to the grantors, to be reported on their person return. As long as the grantors act as trustee, the trust does not need a new or separate Federal Tax ID number, and the trust files no tax return.

All applicable capital gains and losses regulations remain as does mortgage interest deductions, etc.

There are no gift taxes due as a result of transferring property to the trust. When the first grantor dies, his or her property interests are transferred to a "B" trust, if necessary, to preserve the decedent's gift and estate tax exemption. In most trusts the surviving spouse still gets to use this "B" share of the assets.

Grantor Controls, Miscellaneous Features. Grantors are in complete control of the usage of trust property. Trustee signatures are required when property is sold, but normally the trustees are the grantors. Grantors may deal with property in the trust as easily as they could deal with property which is not in a trust. There is minimal paperwork during trust operation.

Asset Protection. In spite of a lot of misinformation, revocable living trusts, such as the Living Trust do not provide "asset protection" for the grantors. All that a revocable living trust does is simply change the legal title to the property. But the grantors retain full control over both the legal title and the economic value of the assets. Since the grantors retain full control over the trust assets, can revoke the trust and can remove assets from the trust, they can easily be

required by a court to use trust assets to pay any judgments against them. If asset protection is very important to the grantors, consider discussing other alternatives with me.

Accessories. Also included with the Living Trust are the following, standard estate planning instruments: Pour Over Will, Durable Power of Attorney, Medical Power of Attorney, Living Will and Guardianship Appointments For Minor Children.

JOINT OWNERSHIP, COMMUNITY AND SEPARATELY HELD PROPERTY

The information in this topic applies only to married and other two grantor trusts (such as parent and child), and does not apply to single grantors. Many couples have multiple forms of ownership of their assets. For example, a wife may individually own property she acquired before marriage, and the same may apply to the husband. In addition they may jointly own property which they acquired after their marriage. The individually owned property or assets are referred to as “separately held”, and mutually owned assets are referred to as “joint ownership”. Ten of the 50 states in the U.S. treat joint ownership property between a husband and wife as “community property”. The other states have different versions of joint ownership, such as “joint tenancy” and “tenants by the entirety”. All 50 states allow another important form of joint ownership known as “tenants in common”.

Most couples will want their assets to retain the same character of joint or individual ownership after the assets are placed into their trust. The wife may want to appoint her choice of beneficiaries for her separately held property, and the same for the husband. More importantly, they likely will want to retain control over their separately held assets after the death of their spouse or in the event of a divorce.

These concerns are provided for with a Living Trust. Language in the trust specifically provides for the three possible ownership methods: Hers, his and joint. In community property states the trust provides for the community property form of joint ownership for jointly owned property within the trust. In other states, the trust provides for the “tenants in common” form of joint ownership for jointly owned property within the trust. In all cases the trust allows for separately held property.

The different forms of ownership are supported by side documents which accompany a joint grantor trust. These documents are entitled “Schedule of Separately Held Property”. There is one schedule for each grantor. The grantors individually fill out their respective schedule, listing their separately held assets. Then the two grantors cross-initial each other’s schedule to acknowledge the separately held nature and the correct owner of those assets. Each grantor will have their own control and/or beneficial interests separately held in their scheduled assets. All assets, which are not listed on one of these schedules, become joint ownership (50/50) when placed in the trust.

DEATH OR INCAPACITATION OF FIRST GRANTOR

The Living Trust contains various terms and provisions to handle an incapacitation of either or both grantors. For example, trust provisions require that assets be held and properly maintained by the surviving spouse and/or the trustee when one grantor becomes incapacitated. This is necessary to ensure that the incapacitated grantor still has his/her assets intact, should the grantor recover. It is also necessary in the event that there becomes a need of providing trust principal for the care or health of the incapacitated grantor. The family and trustee cannot simply begin to distribute trust assets to beneficiaries, even when the trust has only one grantor, where that grantor is permanently or terminally incapacitated.

As a note of caution, when one of the two grantors dies or become incapacitated, there could be some ability of the surviving spouse to use trust property in a manner not allowed by trust provisions. This use might not be in accordance with the wishes of the dead or incapacitated spouse, if that spouse were able to speak or respond. It is important then for the beneficiaries to understand this potential liability, so that they can protect their interests. The beneficiaries have legal recourse for any misuse or abuse of trust property which belonged to the deceased or incapacitated spouse. This does not mean that the surviving spouse can be prevented from full and normal usage of the property. It means that the surviving spouse cannot sell for personal gain or give away the decedent’s trust assets, or allow the property to become seriously or excessively degraded without beneficiary approval or involvements. It also means that no new spouse or companion of the surviving grantor can take control of any trust assets. The beneficiaries can take measures to end or control any such activity by the surviving spouse. This feature is in the best interests of the deceased or incapacitated grantor, as well as the beneficiaries, and is what both grantors agreed upon when they ordered their trust.

BYPASS TRUST UPON FIRST DEATH

When a trust has a married couple as the grantors, most Living Trust instruments will provide for the creation of a “bypass trust” upon the first grantor’s death. The bypass trust provisions all for the interests of the deceased grantor to be separated from the aggregated trust property and placed into the new, bypass trust. There are two reasons that a bypass trust is designed into a married couple trust. The first reason is to preserve the estate tax exemption of the first to die. The second reason is to identify and separately hold the decedent’s interests, so that the decedent’s heirs do not get cut out of the decedent’s estate by inappropriate or neglectful use of the assets by the surviving spouse.

In larger estates, those that exceed the estate tax and exemption of one person, failure to create and fund a bypass trust is an expensive mistake. If the decedent’s interests are not physically segregated into an irrevocable bypass trust, the IRS will very likely treat those assets as being in the taxable estate of the second spouse to die. This means the estate tax exemption of the first spouse to die is lost, and that will cost the final estate up to several hundred thousand dollars in completely unnecessary estate taxes. The only sure way to avoid this problem is to:

1. Physically create new trust documents with a different name for the bypass trust,
2. Obtain a separate Federal Tax ID number for the new trust,
3. Physically transfer property interests to a new trust name in a dollar amount that equals the value of the decedent’s interests, and
4. Limit the surviving spouse’s access to trust principal per the provisions of Federal Tax law. (The surviving spouse generally has the income; use and benefit of the bypass trust assets. In addition the surviving spouse can have as much trust principal as necessary, as long as the trustee is either a remainder beneficiary or an independent trustee.)

With married couples, each one wants to go to their grave knowing that:

1. They have left the appropriate use of their share of the property interest to their surviving spouse, to use as he/she truly needs, but that,
2. The remainder will go to his/her children or heirs.

If the interests of the first to die are not physically identified and segregated, there is no way to assure, or even know whether those interests are appropriately used and preserved for the ultimate heirs.

You need to understand these provisions up-front and need to agree almost without exception. Quite often, however, the surviving spouse forgets the wishes of the deceased spouse and opposes the formation of the bypass trust. However, the trustee (usually the surviving spouse) is legally obligated to set up the bypass trust anyway, and could be sued by the beneficiaries for not doing so. The trustee is legally bound by the trust contract he/she signed with the decedent when the trust was created.

DEATH OR INCAPACITATION OF SECOND GRANTOR

When the second or only surviving grantor becomes incapacitated or dies, the successor trustee steps in and begins active administration of trust property, or makes arrangement with the beneficiaries to take care of it. There are specific provisions in the trust for the successor trustee and/or beneficiaries to take care of the needs of an incapacitated grantor, and any minor children there may be in the family. (There may be other heirs that need special care, too. The successor trustee will take care of them, financially, if that is called for in the trust. The grantors should make sure this provision for other heirs is in the trust if the need exists.) Once the second or sole surviving grantor dies, the standard trust language calls for the successor trustee to divide the property equally among the heirs, sometimes distributed to them at different age milestones or over their remaining life times. However, your trust may provide for something different depending upon your specific needs.

REVOCABILITY AND AMENDABILITY

The trust is fully revocable and amendable, in virtually any way, as long as the grantors are alive and not incapacitated. In fact, the trustee is instructed by trust language to automatically amend the trust in any way necessary to conform to,

or take advantage of new and applicable laws and court decisions. The successor trustee can amend the trust without permission in any way that benefits the trust, and that does not harm the interests of the grantors or beneficiaries.

When one grantor becomes incapacitated, or dies, that grantor's interest in the property is held irrevocably in the trust or in a bypass trust, and the bypass trust cannot be amended in any way that changes the intent of the grantor. This is all necessary to protect the intent and wishes of the incapacitated or deceased grantor, since he can no longer speak for himself. The surviving grantor still has the above mentioned revocability and amendability over his/her own interests in the assets (usually a one half interest). The surviving grantor will in most trusts have the income, use and benefit of the property interests of the deceased grantor as well.

When the second grantor or only grantor dies or becomes incapacitated, that grantor's wishes and intents become locked in place by the trust. The beneficiaries who are identified in the trust can legally enforce this irrevocable status, and all the trust provisions, provided they have been made aware of their benefits and rights.

ESTATE PLANNING

The Living Trust generally accomplishes the following:

1. Trust assets will be conveyed to the selected heirs or beneficiaries in the manner and timing the grantors have chosen.
2. Trust assets will avoid probate.
3. The trust will prevent a surviving spouse from conveying assets of the decedent to a new marriage partner or to anyone else except the original designated beneficiaries.
4. Trust assets may avoid twice as much in estate taxes for a married couple, than may be avoided with a non-trust estate.
5. The successor trustee can take care of trust assets if the grantors become incapacitated, in an orderly and legally controlled manner.
6. The trust usually has a provision that heirs receive their portion of the estate only after reaching a certain age. Often, the trust will specify that the heirs receive a percentage of their share at each of two or three different age milestones.

Most estate planning needs can be served with trusts, often better than with any other method of holding the assets. For example: Provisions for what happens if the grantors wish to provide for an heir who is disabled, if the grantors die with minor children, if the grantors want to make a charitable gift or want to change an heir's portion of the estate, or want to reserve some specific item or property for a certain beneficiary, etc., all can be handled with a trust. But, if you as a grantor are not sure, please contact me with any and all applicable concerns and pertinent estate questions you now have. Some estate planning needs can be met after the grantor's property has gone into the trusts, but some can only be done before the property is put in.

There are some additional general provisions that your trust system probably contains that you should be aware of:

1. As long as the original grantors are alive and legally capable, they may change the beneficiaries of the trust in any way they want. When one of the grantors dies or becomes mentally incapacitated, the beneficiary arrangement is locked in place for interests of the deceased grantor (usually one-half of the total trust), unless the beneficiaries themselves agree to further changes. This lock-in provision protects the wishes of the deceased grantor in regards to who will inherit and what they will inherit.
2. The trust will automatically include future children, whether by birth or by adoption, of the grantors as an equal beneficiary to the pre-existing children.

PREPARING PERSONAL FINANCIAL STATEMENTS

In many cases the grantors will want to produce personal financial statements that include all trust property in the list of assets on their financial statement. This is legal and proper provided that the financial statement contains a footnote notation on the asset list with footnote language something like the following: "Assets held in trust for my/our benefit". This notation is proper because the grantors have not given up their economic interest in the assets; they have only changed the legal title. Since they continue to own the economic interests and they control the legal title, they may properly value those interests (the assets) on a personal financial statement. The existence of the footnote should not inhibit the grantors' ability to use the financial statement to obtain credit.

BOOKKEEPING

Once the grantors die or become incapacitated the successor trustee has a legal liability to maintain bookkeeping for the purposes of annual reporting to the beneficiaries. During the active lives of the grantors they should assist the successor trustee in keeping up with what is in the trust and what activities are going on. The grantors usually receive all trust financial statements, for example, and often handle any trust check writing and deposit activity. The grantors may place additional assets into the trust without the successor's knowledge. In order for the successor trustee to competently fulfill his role on the death or incapacitation of the grantors, the successor trustee should receive at least on copy per year of financial statements and records. The successor Trustee should also be up to date with a list of trust assets (and debts or other liabilities). So in addition to financial statement copies, the successor trustee needs a copy of all deeds, titles and bills of sale for physical assets in the trust. The successor trustee needs records regarding life insurance policies, annuities and pension plans which name the trust as either or both owner or beneficiary.

INFORM THE BENEFICIARIES

While privacy of their financial affairs may be important to the grantors, it is vital that the beneficiaries be informed of at least some minimum details. If the heirs know nothing about the trust, which the grantors have set up, they could lose some of what the grantors wanted them to have. One scenario that could cause a problem is when one of the two grantors dies, and the surviving spouse remarries someone who is not motivated to look after the best interest of the original beneficiaries. Other problems can occur when the grantors become elderly and fail to adequately take care of trust property or records. Another problem situation can arise when the grantors die or become incapacitated while possessing special knowledge that no one else is aware of, such as the details of certain projects or deals, the location of certain records, safe deposit boxes, etc. When a grantor dies, the surviving grantor could make improper use of the decedent's trust property the harm of the beneficiaries. And, the surviving spouse will quite often strongly resist setting up the bypass trust. But that trust is necessary to protect the beneficiaries' interests. (See the earlier topic "Bypass Trust Upon First Death" for more information.)

Beneficiaries can legally enforce their interest and can be a significant factor in making sure the trust does what the grantors originally intended. As an extra measure of precaution, the grantors should consider the following recommendations:

1. Make the beneficiaries aware of the existence of the trust, and the identification of the successor trustee.
2. Make the beneficiaries aware of their rights and benefits.
3. Give the beneficiaries copies of the trust, it discloses their interest.
4. Inform the beneficiaries of the general workings of the trust structure (have them read or give them a copy of this guide) and fill them in on basic details.
5. Inform the beneficiaries of the location of all trust and other important records. Make sure they can easily gain access to these records in any emergency.
6. Give a copy of all financial records, deeds, titles and conveyance documents to the successor trustee and/or beneficiaries.

TRUST DOCUMENT STORAGE

The grantors receive the original trust documents for safekeeping. The successor trustee should keep a duplicate set of originals. But, other documents, such as deeds, bills of sale, titles, deposit slips, etc., may be generated by the

grantors, and which are one of a kind. It is extremely helpful to give photocopies of financial records, deeds, titles, and other conveyance documents to the successor trustee so that he/she can easily handle trust property in an emergency.

I recommend that the grantors place their original documents in a bank safety deposit box, or in a filing cabinet, lock box or safe that is fireproof, and that the successor trustee and beneficiaries all know about the location.

CHAPTER 2

FUNDING AND SETTING UP THE TRUST

The process of funding (transferring assets to) trust faces some time constraint concerns. It is important that all assets be conveyed into the trust in as short a time frame as possible. This is necessary to help avoid the problem of encountering a lawsuit, grantor illness or death in the middle of the setup process. In addition, the trust is worthless or not fully effective without the conveyance of all intended property into it.

RECORD ORGANIZING SYSTEM

A Living Trust is placed in a two sided pocket folder inside a binder. The folder allows the trust to be kept in the front pocket, with the pertinent records of that trust being kept in the back pocket of the same folder. The Living Trust documents should contain a listing or should physically hold deeds, records and the actual documents of all real estate, financial accounts, insurance policies, bills of sale, stock certificates, etc. which name the Living Trust as owner or beneficiary. If the records and documents are not kept with the trust, there should be a statement with the trust indicating where its records may be found. Proper record storage and availability are vital when the heirs and trustee need to step in and take care of trust business.

BANK ACCOUNTS

Opening New Bank Accounts. The trust does not need a bank account unless the trust receives income, especially from multiple sources. In many cases, trust investments will be held in a brokerage account which has check writing privileges, making a separate bank account necessary. If a trust bank account must be opened, use the following procedure: Take a copy of the “Certificate /Affidavit of Trust” plus the “Trust Resolution and Banking Authorization” to the chosen bank. Both these documents are furnished with the trust. Do not furnish your bank with or allow them to make a photocopy of your entire trust. This compromises privacy; they do not need this document and cannot legally require it.

Request from the bank a trust account. Some banks are unaccustomed to opening trust accounts and often have some confusion in trying to determine how to meet your request. If the bank does not have a specific account type for the trust they may want to open a general business or commercial account instead. This type account will work for the trust too.

The name of the account and the name printed on the checks should be the name of the trust. Do not allow the names of the grantors to be used on the account or on the printed checks as account owners. The bank will require a Tax ID number to open the account. This number will normally be one of the grantor’s social security number; it is furnished with the trust, printed on the cover page and listed on the “Trust Resolution” document. The mail address for the bank account (and the trust itself) is normally the mailing address of the grantors.

Existing Bank Accounts. The grantors may have existing bank accounts or brokerage accounts with check writing privileges, which they use primarily for personal business. These accounts do not need to be placed in the trust. They are much simpler to use when they are left directly in the names of the grantors. However, the grantors do want the account balance to go to the trust upon their deaths. Therefore go to the bank of financial institution and ask for a “payee on death” (POD) provision for the account. Then list the Living Trust as the POD. This provision specifies that upon the death of the last account owner/signer, the remaining balance is to be paid to the trust. In other words, the trust is the remainder beneficiary of the bank account. This allows the grantors to use the account without hindrance during their life, but assures that the balance will go to their heirs according to the plan in the trust.

FINANCIAL AND BROKERAGE ACCOUNTS

Upon request, the Living Trust can be furnished with a form letter that may be used to change ownership to the trust for financial accounts and brokerage accounts. (This topic is not referring to bank accounts. For information on this, see the topic above.) This letter can be identified by the greeting line, which says, "To Whom It May Concern". The blank form of this letter should be copied, making a copy for each institution which is to receive one. After filling out the blanks in the letter, each grantor or spouse signs the letter in front of a notary. The final step is to send the notarized letter to the appropriate institutions. In many cases, these institutions will simply send back their own special forms for completion and signing, so the form letter I am discussing here has limits to its usefulness and in fact its usage is optional. The letter can, however, be used as the initial communication to these institutions, which prompts them to send you their forms.

Filling out and signing these letters can be legally binding transfers. The letters may therefore be useful in requiring the institutions to complete the ownership changes even if the grantors die or become incapacitated before the accounts are changed. Further, these letters are a good way to fully identify all the grantors' financial accounts and instruments that need to be in the trust. Execution of these letters right away is a good idea for the reasons alone.

ANNUITIES

Normally, you will want to make the Living Trust the primary beneficiary and owner of commercial annuities. This is due to the need to provide trust management for the large, lump sum payoffs in the event of the annuitant's untimely death. However, it is vital that the insurance company which is the annuity issuer understand the nature of the trust ownership of the annuity. Otherwise there may be negative tax consequences.

The Living Trust is a legal owner of annuity contracts, and is legally entitled to have tax deferred status in annuities because of two facts:

1. The trust is a "grantor" trust under Internal Revenue Code (IRC) Sections 671-678,
2. The trust is an agent for a natural person under IRC 72 (u)(1).

If the insurance company fails to know and to fully comprehend these two facts, they will:

1. Treat transfers of existing annuities to the trust as a taxable event, and issue a 1099 too the annuitant.
2. Treat the purchase of new annuities by the trust as not having tax deferred status, and issue annual 1099s for the income of the annuity.

To assist with the transfer of existing annuities to the trust, upon request, I can supply a special transfer letter for annuities which is included with the other transfer documents of your trust. This letter can be identified by the line, near the top, which says, "Re: Change of Owner and Beneficiary of Annuity Contract(s)". This letter has the above mentioned tax law citations and hopefully will work with your insurance company.

However, some insurance companies are uncooperative in either the transfer to or the issuance of annuities to trusts. They may refuse to assist you at all, may state that a 1099 will be issued upon transferring ownership to the trust, or they may state that no deferral can be had with a new purchase. If you encounter these problems, existing annuities can be transferred from uncooperative companies to a company which is cooperative through the use of a procedure known as a "1035 exchange". For new annuities, simply shop for an insurance company which is cooperative.

LIFE INSURANCE

Normally, the grantors will want to make the Living Trust the primary beneficiary and owner of life insurance policies. This is due to the need to provide trust management for the large, lump sum payoffs or death benefits. The best way to make changes in life insurance ownership and beneficiary arrangements is to contact either the agent who sold the policy, or contact customer service at the life insurance company. There is an "absolute assignment" letter included with the trust which can be filled out and sent to the agent or to the insurance company as a way to initiate contact, and as a way to document up front what policies are to go into the trust.

Note: Be aware that by intentional design, a Living Trust does not remove any value from the grantors' taxable estate. As a result the death benefit of life insurance policies in the trust will be included in the taxable estate of the insured, or the surviving spouse. If the death benefit is large enough to cause an estate tax problem the grantors should seriously consider putting life insurance policies in an irrevocable life insurance trust, such the applicably named and used Irrevocable Life Insurance Trust which I can design specific for your needs.

EMPLOYER BENEFITS

Usually, the employer is the owner of the life and disability plans that it furnishes its employees. But consider making the trust either the beneficiary or the contingent beneficiary of the benefits plan where applicable.

RETIREMENT AND BENEFIT PLANS

In all Living Trusts, an important and special pension planning language. The special pension section of these trusts (entitled, *Trust as Beneficiary of Pension Plans*) gives the trustee all the power and flexibility necessary to deal with qualified plans in order to minimize income and estate taxes, and allows for IRA stretch planning. The pension section includes the necessary language to satisfy IRS requirements.

Where the trust is to be the beneficiary of a pension plan, the special pension section provides: (a) That the trust is or must become irrevocable upon the death of the grantor and pension plan owner, (b) the trustee is empowered to make up any deficits below the minimum distribution requirements of the pension plan (otherwise, the deficit would be taxed at trust rates, rather than the beneficiary's rate), (c) special provisions to qualify the trust as a "designated plan beneficiary", (d) that the beneficiaries must be individuals who are identifiable from the trust document, and that the trust can not leave plan benefits to a class of beneficiaries or a charity, and (e) the trust document must be provided to the plan custodian or administrator.

This means that a correct family trust document is a legally proper and sufficient vessel for planners to use when implementing pension transfer strategies. When should a trust be named as the beneficiary of an IRA or other pension plan? Very generally, here are some guidelines:

1. Where the pension plan is large, presents an estate tax problem, and the plan owner is married, then: Consider naming a Living Trust or family trust as the primary holder and/or beneficiary of the plan. For married couples, the trust allows the trustee to make the surviving spouse a life beneficiary of the plan. This causes inclusion of the plan in that spouse's estate, while at the same time preserves stretch distribution provisions for remainder beneficiaries. Including the plan in the surviving spouse's estate, via the unlimited marital deduction, gets the plan out of the deceased owner's estate and gives the surviving spouse a change to spend the plan down to a manageable estate tax level. Other assets can then be placed in the deceased plan owner's bypass trust to benefit from the decedent's estate tax exemption for those assets. In any case, the trustee will do the planning and make appropriate decisions after the death of the plan owner, and the trust gives the trustee both the power and the flexibility to do whatever provides the best tax and estate planning result.
2. Where a married plan owner's pension assets are not likely to cause an estate tax problem, and especially where the surviving spouse is likely to use up most of the plan, it will often make the most sense to name the plan owner's spouse as the primary beneficiary, rather than the trust, and then name the trust as contingent beneficiary in case the plan owner survives his/her spouse.
3. Where a plan owner is not married, there are multiple beneficiaries among whom the plan is to be divided, and regardless of whether or not the plan is likely to represent an estate tax problem: The trust should be named as primary beneficiary. Of course there can be no estate tax planning via the marital deduction with an unmarried trust grantor, but the trust does provide for stretch planning, to minimize income taxes, among the remainder beneficiaries.
4. Where a plan owner is unmarried, there is only one heir who will be beneficiary for the plan, and regardless of whether the plan is likely to cause an estate tax problem: It may make sense to name the one heir as direct primary beneficiary of the pension plan, and name the trust as a contingent beneficiary. But, if the primary beneficiary is a minor, it may be best to name the trust as the primary beneficiary of the pension plan, with no contingent.

Basic IRA Stretch Planning Concepts:

Note: The following is a reprint of an article in the December, 2003 issue of Estate Planning Journal, written by The Estate Planning and Administration Group of Schiff, Hardin & Waite, a large law firm and pension planning expert resource located at 6600 Sears Tower, Chicago, Illinois 60606-6473.

“Trusts as beneficiaries or retirement benefits continue to cause problems for estate planners, in part because of unnecessary complexities foisted upon us by the IRS. Final Regulations issued by the IRS permit a trust to be a designated beneficiary if certain requirements are met. They include that the trust must be valid under state law, the trust must be irrevocable no later than the death of the account owner, the beneficiaries must be identifiable, and certain documentation must be furnished to the plan administrator or IRA custodian by October 31st of the year following the account owner’s death.”

“If all these requirements are met, and assuming that only individuals can benefit from the retirement plan or IRA proceeds, then the oldest beneficiary of the trust is deemed the “designated beneficiary”. It is this designated beneficiary whose life expectancy can be used to determine the minimum distributions required from the plan or IRA. If there is no designated beneficiary, the remaining proceeds have to be paid out over a five-year period (if death occurs before the required beginning date) or over the projected remaining life expectancy of the decedent immediately prior to death (if death occurs after the required beginning date).”

“In some situations, using the oldest beneficiary’s life expectancy is not a significant hardship. If the ages of the client’s heirs are only a few years apart, the difference in the minimum distribution requirements from oldest to youngest is probably relatively small. On the other hand, if the range of ages of the heirs is greater, as may be the case if the client has children from different marriages, there can be a significant loss of benefits to the client’s family if the oldest beneficiary’s life expectancy must be used for all the beneficiaries.”

“Under IRS Proposed Regulations, it appeared that as long as subtrusts for the children were created immediately at the account owner’s death, the “separate account rules” would permit each child to use his or her life expectancy for purposes of distributions to his or her trust. However, the final Regulations eliminated that provision and instead say that the separate account rules “are not available to beneficiaries of a trust with respect to the trust’s interest in the employee’s benefit.” (Reg. 1,401 (a) (9)-4, Q&A-5(c). Three related private letter rulings confirm that the IRS no longer believes that the separate account rules apply in this case.”

“In IRS Letter Rulings 200317041,200317043, and 200317044, the decedent died at age 60 with an IRA. The decedent had designated his revocable trust as his beneficiary, but had also provided in the beneficiary designation that the trust was to be divided into separate trusts for his three children. The trustee of the revocable trust was also authorized in the beneficiary designation to create separate IRA accounts for each child, which was done after the decedent’s death. The trustee duly created the three separate trusts for the children and no amounts from the IRA were ever paid to the initial, undivided revocable trust.”

“Despite this, in an unfortunate example of form over substance, the IRS ruled that the separate account rules did not apply. The IRS stated that the separate trusts for the children were not created by the decedent, rather, they had been created by the trustee after the decedent’s death. The IRS viewed this situation as plan amounts passing through the original revocable trust, and concluded that the oldest child’s life expectancy must be used to determine the minimum distributions for all the children’s trust. This reasoning would apply to your client’s situation as well.”

“So what can you do? It seems that the client must actually create the separate trusts under the revocable trust **before** the client dies. Perhaps the revocable trust can set up a trust for each heir’s ultimate benefit now, fund it with \$10.00, and then have the revocable trust pour over into these separate trusts at the client’s death. The IRA plan’s beneficiary designation must provide that each of the trusts receive the appropriate fractional amount, rather than simply requiring that the proceeds be paid to the revocable trust. (Plan administrators and IRA custodians may need to start adding lines on their beneficiary designation forms.) Separate IRA accounts could also be used, but the beneficiary of each would still have to be a separate trust for the heir/beneficiary in existence prior to the client’s death.”

SAFETY DEPOSIT BOXES

Safety deposit boxes are handled similar to the bank account arrangements. The trust can be named as a joint tenant/signer on an existing box, or a dedicated box owned by the trust can be rented. The main trust documents

should contain information indicating where the safety deposit box is located, what it contains, and where the records and keys are kept. This will help the successor trustee to step in and take care of trust business when that is necessary.

CONVEYING REAL ESTATE

The exact method by which the real estate conveyance documents are created is critical. If the transfer is not handled correctly it may cause the title to become clouded or uncertain. An obscure title would most likely prevent or delay a future sale of the property. This could require court intervention to solve the problem. Problems with a clouded title can be extremely expensive and a time consuming nightmare. Real estate titling is a whole field of expertise of its own.

Something extra you should be aware of is, most title insurance is transferable to a trust when the real estate owners or their families are the beneficiaries of the trust. Make sure to have this important service follow the real estate into the trust whenever possible.

Real Estate Transfer Taxes. Transferring ownership of real estate to a trust may cause a re-assessment of property taxes due to the county or state viewing the transaction as a sale. When a re-assessment is enforced it is usually due to the county thinking the property was sold. These re-assessments do not apply to transfers to revocable trusts where the grantors or their direct heirs are the beneficiaries. In some states the transfer can cause substantial transfer taxes to be incurred, but using the right type of deed and/or language on the deed should prevent these taxes.

Real Estate Deed Choice. To convey either developed or undeveloped real estate into a trust requires a deed. The type deed required varies from state to state. The most common are quit claim, warranty and grant deeds. Different states have their own variations of a given type deed and in conveyance procedures. Sometimes these variations are substantial. Also there may be special situations with any given property that causes some unusual requirement, and the above referred to transfer tax issue must be considered.

It is recommended that a quit claim deed not be used except for the following: The quit claim type is necessary to prevent tax re-assessments or transfer taxes. While quit claim deeds are commonly used to convey real estate into a trust, technically these deeds do not transfer title. They merely release a claim that the signer may have on the property. It costs no more to use a "Deed in Trust" (or grant deed where applicable).

Deed Conveyance Language and Recording. A trust has special requirements for the actual conveyance language that goes on the deed. The "Grantor", the transferor of the real estate, must use the full name and creation date of the trust that is to receive the property, and follow that with some special language about the trustee. Below are conveyance language examples for the most common trustee arrangements.

Private individual (or one grantor) as sole trustee:

to...Farmer Family Trust, dated January 3, 2000, with Fred Farmer of (city & state) and Beverly Farmer of (city & state) as co-trustees, said co-trustees and any successor trustees having full power to convey title when acting jointly....

Additional Recording Requirement. In addition to recording the deed at the County Recorder's office, it is recommended, sometimes required, that another document be recorded with the deed. This document may be referred to as either: Certificate of Trust, Affidavit of Trust or Memorandum of Trust in your state. I furnish a version of this document with every trust, which is entitled "Affidavit/Certificate of Trust". A number of states require that either this document or the entire trust be recorded. But recording the entire trust is both expensive and is a compromise of privacy, and the affidavit/certificate of trust will meet all needs. So you will likely want to record only the affidavit/certificate.

The purpose of recording the affidavit/certificate of trust is to make certain there is a permanent and clear legal record for any future conveyance of the real estate out of the trust. In any future real estate conveyance out of the trust many title attorneys and title companies will require written proof of the trustee arrangements, trustee succession provisions, and powers of the trustee to convey title. The affidavit of trust provides that and other needed information for evaluation of the transferability of trust property. Recording this information up-front removes all questions concerning future transferability. There will be no problems later if trustees were changed (using proper trust

procedure), if none of the original parties are around or if trust copies have been lost. Taking a long-term view of perhaps twenty to fifty years makes trust affidavit recording all but an absolute must.

Notify the Mortgage Company. If there is a mortgage on the real estate the lender's permission should be sought to transfer the property into trust. There may be a "due on sale" clause in the note that the lender could attempt to use to call the note if the lender did not give advance permission. Various state and federal laws prohibit the mortgage company in most cases from denying this permission for trust transfers for intra-family usage. The lenders rarely give any difficulty in granting permission, but if they do the law is on the grantors' side. The purpose of advance permission is to avoid a conflict or nasty surprise later over the lender's attempts to call the note.

When the mortgage company is contacted, it is highly important that you make them understand that the transfer is an "intervivos trust of which the borrowers are the beneficiaries and will remain as occupants of the property".

Notify the Insurance Company. Be certain to notify the property and casualty insurance that covers the real estate (or other property) before transferring the asset to the trust. Various insurance companies will handle the policy differently, but typically they will name the trust as an "interested party" or as a co-insured. Without this notification and change the property insurance may not be in force after the property is placed in the trust.

AUTOMOBILES, TRUCKS, RVs, ETC.

Retitling. Go to the appropriate state agency where auto titles are changed, and transfer the title into the name of the trust. If you explain that you are just changing the owner's name, and are not selling the vehicle, and/or that you are transferring the property into a revocable trust of which you are the current beneficiary, most states will make the transfer without charging a sales or excise state. There is usually just a nominal transfer fee. However, some states may treat the transfer as a sale, even though no money changed hands, and even though the only difference is a name change. If you cannot avoid a high tax on this transfer, consider waiting until you purchase your next vehicle, and then titling it in the name of the trust from the beginning.

Mortgaged Vehicles. When there is a mortgage on the vehicle, the lender usually holds the title or has a lien against it. In those cases you have to approach the lender for assistance in getting the title transferred. Most large lending institutions are not customer friendly enough to help with this, though there is no legal or financial reason they cannot help you. They would still have a lien on the vehicle and its title after you exchanged the title to the trust name, but they usually remain opposed to helping you.

"Workaround" Solution for Vehicles. If problems with either the state vehicle agency or the lender prevent retitling the vehicle in the name of the trust, there is a workaround that still accomplishes an effective trust transfer. This can be done by signing the title over to an unnamed (un-listed) buyer without making an official transfer with the state. Then keep the signed title with trust records. Upon the death of the last of the grantors, the successor trustee can take the signed title to the state and complete the transfer to the trust, or sell the vehicle outright and put the cash in the trust.

Leased Vehicles. Most vehicle leases will not allow the vehicle to be transferred into a trust, and few drivers have sufficient equity in their leased vehicle to be worth including in their estate planning. If the equity is deemed to be significant, the successor trustee will want to work out an assumption of the lease upon the grantors' deaths.

Notify the Insurance Company. Be certain to notify your auto insurance agent that this change in ownership will occur. Usually, the best way to handle the insurance policy is to have the trust listed as an interested party, co-insured or as an additional insured. If nothing is done with the insurance policy there may not be insurance in effect after the vehicle is transferred into trust. Rely on your insurance agent for the best way to handle this.

TRANSFERRING NOTES RECEIVABLES

Property that the grantors are carrying paper on, such as a Deed of Trust, not receivable, etc., may be transferred to the Living Trust unless language in the paper prohibits a transfer. Even in that case you still may transfer the interest of that paper (the payments) to the trust. In both cases send a copy of the Deed of Trust and a notice to the payer directing him or her to henceforth send the payments to the Trustee in the name of the trust. Then use a bill of sale as the transfer document to move the ownership of the paper to the trust.

TRANSFERRING BUSINESS INTERESTS

To change ownership of publicly traded securities, generally use the information in the earlier topic with the heading “Financial and Brokerage Accounts”. When you directly hold stock certificates, generally use this section for transfer information. However, I always recommend against placing personally owned business enterprise directly into a Living Trust, due to the risk of lawsuits against the business attaching to you and your Living Trust. Use either a limited liability company (LLC) or a corporation to own and/or operate the business enterprise.

Proprietorships. As stated in the above paragraph, do not place proprietorship businesses in a Living Trust because of the increased lawsuit risks that businesses face. The operation and management of the business should be handled with a limited liability company or a corporation, and not by your trust. This includes the management of rental real estate. You should not manage real estate or collect rents in the name of your Living Trust. Real estate management also should be handled by an LLC or corporation.

Corporate Stock. If you hold physical share of corporate stock, as opposed to having them in a brokerage account, then the following instructions apply. Both C and S* corporation shares can be readily transferred to the Living Trust. Generally, corporate shares are represented by certificates, with an assignment of ownership section on the backside of the certificate. After the assignment is made to the trust the shares normally would be turned in to the corporate secretary, who issues replacement shares directly to the Living Trust. When the transfer is complete, be certain to keep copies or the originals of the reissued shares with the Living Trust records.

- The special tax status of S corporations will not be compromised as long as the grantors are alive and are still the current trust beneficiaries. The Living Trust is a “grantor” trust and Federal tax laws view the shares as still being held by the grantor(s). After the death of the last grantor, S shares in the trust will require sale or disbursement within two years, or the filing of a special “QSST” election.

Partnerships. Some or most partnership agreements will require permission of the other partners for one partner to make a change in the ownership of partnership interests. Normally, the other partners will not have a problem with this when the new owner is a family trust. There is no uniform or standard procedure for transferring partnership interests. Make all transfers of partnership interests to the Living Trust and keep copies of the paperwork with that trust.

BILL OF SALE DOCUMENT

A customized bill of sale can be supplied with each Living Trust, with a few blanks for the grantors to fill out. Use a bill of sale to convey untitled personal and physical property to the Living Trust. You do not need a bill of sale for real estate, vehicles with titles, or financial accounts with banks, stock brokerages and other financial institutions. You also do not need to use a bill of sale for personal effects (handled by the “Disposition of Personal Effects documents) or household items (handled by the Schedule A”). Common personal property items requiring a Holding Trust and a bill of sale include things such as: untitled business and other equipment (like computers, manufacturing equipment, etc.), un-titled vehicles (such as small watercraft and snowmobiles), and possibly guns (though these are usually handled with the “Disposition of Personal Effects” document). These items are “personal” whether they belong to an individual or to a business.

If there isn’t enough room on one bill of sale to list all the property going into the trust, you can do one of two things. (1) Make additional copies of the bill of sale before you enter any information on the original, and then use multiple copies to list all the assets, or, (2) list the property on a separate sheet of paper and attach it to the bill of sale. Then in the “Assets Conveyed” blank on the bill of sale, write in the words, “See Attached List”. Then, have the trustees and the grantors initial the attached list.

Filling out the notary section is optional, but doing it does make a slightly better legal document.

The bill of sale does not need to be recorded with the County Recorder. Simply keep one copy with the trust documents, and one in the trustee’s files.

SPECIFIC GIFTS OF PERSONAL ITEMS

The gifting of personal effects to specific heirs is handled with a two-part document. The first part is called “Bequeath of Specific Gifts”, and the second is the “Memorandum of Disposition Of Personal Effects”. There is a pair of these documents furnished for each grantor with each Living Trust. They are very simple to understand and implement.

The Bequeath documents grants personal items to the ownership of the trust with a life estate interest being retained by the grantor in the personal effects. After the grantor dies, the trustee will use the “Memorandum” to transfer the personal effects to the proper heirs. The grantor retains the power to change the list of effects and the beneficiaries at any time, and as often as he/she wishes. Before using the “Memorandum” document make copies of it so that you can fill out new versions in the future. Any time you do this mark the old one “Void”; very clearly or just throw all original copies away.

This keeps control and usage of the effects with the grantor, and allows total freedom to select and change heirs for these effects. But, since they are conveyed to the trust these items will avoid probate. This process will also help a great deal in eliminating intra-family quarrels over these items. Please read the complete text of the “Bequeath” document.

COMMON HOUSEHOLD ITEMS

Property such as furniture, kitchen items, wall décor, fixtures, electronics, etc. are listed generically on a document furnished with the Living Trust, entitled “Schedule A”. Simply signing this document and keeping it with the Living Trust records is an effective transfer of these items to trust ownership. The list is broad enough to include virtually anything of value found in the average home, but there is room on the Schedule to list anything specific where necessary. Do not rely on this Schedule to transfer personal effects and family heirlooms to specific heirs. That should be done with the “Bequeath of Specific Gifts” document referred to above.

THE STEP-BY-STEP TRUST SETUP

The steps below are simplified, initial setup instructions. Detailed information on these steps is contained in the preceding pages of this guide. Perform these steps in the order listed:

1. Open a Living Trust bank, investment and savings accounts if any are required, and/or retitled existing accounts to the name of the trust. Usually exclude personal bank accounts from retitling, and use a “payee on death” (POD) designation instead on those accounts.
 - a. Retain the initial deposit slips and/or account statements with the Living Trust. This provides proper record keeping.
2. Convey real estate to the trust, (Also see the “Conveying Real Estate” topic of this guide.)
 - a. Contact mortgage companies first or written approval to change ownership of real estate.
 - b. When approval is received, change ownership and title to the name of the appropriate trust(s), using preferably a warranty (or grant) deed, and handled by a title company.
 - c. Notify insurance agents of change in ownership.
 - d. Record deeds and a copy of the Affidavit/Certificate of Trust (optional) at County Recorder’s office, in the same county where the property is located.
 - e. When the recorded deeds are returned by the county, retain them with Trust documents.
3. Convey personal property and vehicles to the trust. (See the “Automobiles, Trucks, RVs, Etc.” and “Bill of Sale” topics of guide).
 - a. Make an inventory of equipment, untitled vehicles (and possibly guns) that are to go into trust. Do not include items that are listed on the “Disposition Of Personal Effects” or Schedule A documents.

- b. List the above items on a bill of sale (furnished with each Holding Trust). If the items are too numerous, attach separate lists of the items to the bill of sale as an exhibit, or use several bills of sale.
- c. Get bills of sale signed by grantors and trustees. Retain completed bill(s) of sale with trust documents.
- d. Vehicles. Notify insurance agent, in advance, of the title change and of the upcoming name change. Change vehicle titles to appropriate trust name, and retain new title with the trust.