425-880-9066
info@rjglegal.com

GREGOREK AND ASSOCIATES PLLC
Legal and Tax Services

10604 NE 38th Place
Suite 225
Kirkland, WA 98033

Understanding Funding Your Living Trust

1. Introduction to Funding

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 can 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, divorce proceedings and irresponsible spending.
Still, many people make a big mistake that sends their assets right into the court system: 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 name of your trust. You will also change most beneficiary designations to your trust.

3. Who controls the assets in my trust?

The trustee you name will control the assets in your trust. Most likely, you have named yourself as trustee, so you will still have complete control. One of the key benefits of a revocable living trust is that you can continue to buy, sell, and use your 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 will not avoid probate. Your living trust can only control the assets you put into it. You may have a great trust, but until you fund it (transfer your assets to it by changing titles), it doesn't control anything; your living trust can only control the assets you put into it. If your goal in having a 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?

Along with your trust, your attorney will prepare a "pour over will" that acts like a safety net. When you die, the will "catches" any forgotten asset and sends it to your trust. The asset will probably 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 handle some. Most attorneys will transfer your real estate, then provide you with instructions and sample letters for your other assets. 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 may 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

trustees, but it does not reveal any information about your assets, your beneficiaries and their inheritances.

While the process isn't difficult, it's easy to get sidetracked or procrastinate. Just make funding your trust a priority and keep going until you're finished. Make a list of your assets, their values and locations, then start with the most valuable ones and work your way down. Remember 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 idea is that all of your assets should be in your trust. However, as we'll explain, there are a few assets you may not want in, or that cannot be put into, your trust. Also, your attorney may have a valid reason (like avoiding a potential lawsuit) for leaving a certain asset out of your trust.

Generally, assets you want in your trust include real estate, bank/saving accounts, investments, business interests and notes payable to you. You will also want to change most beneficiary designations to your trust so those assets will flow into your trust and be part of your overall plan. IRAs, retirement plans and other exceptions are addressed later.

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

In most cases, you will notice little difference. You may even find it easy to transfer real estate you own 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 that is 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, retitling 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.

Also, having your trust as the owner on your homeowner, liability and title insurance may make it easier for a successor trustee to conduct business for you. Check with your agent.

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?

Property that has been contaminated (for example, from a gas station with underground tanks or by a printing facility that used chemicals) can be placed in your living trust, but the trustee can be held personally responsible for any clean up. If you are your own trustee, this is a moot point because, as the owner, you are already responsible. But if cleanup 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 can 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. Federal estate taxes must be paid if the net value of your estate when you die is more than the amount exempt at that time. Some states have their own estate/inheritance tax, and it is possible your estate could be exempt from federal tax and still have to pay state tax.

Your taxable estate includes benefits from life insurance policies you can borrow against, assign or cancel, or for which you can revoke an assignment, or name or change a beneficiary. If your estate will not have to pay estate taxes, naming your living trust as owner and beneficiary of the policies will give your trustee maximum control over them and the proceeds.

If your estate will be subject to estate taxes, it would be better to set up an irrevocable life insurance trust and have it own your policies for you. This will remove the value of the insurance from your estate, reduce estate taxes and let you leave more to 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 transfer date, the IRS will consider the transfer invalid and the insurance will be back in your estate. There may also be a gift tax. These restrictions, however, do not apply to new policies purchased by the trustee of this trust. If you have a sizeable estate, your attorney will be able to advise you on this and other ways to reduce estate taxes.

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 if you are at fault in an auto accident and the injured party sees that your car is owned by a trust, he or she may think "deep pockets" and be more likely to sue you.

Most states allow a small amount of assets to transfer outside of probate; the value of your car may be within this limit. Some states let you name a beneficiary; in some, cars do not even go through probate. Your attorney will know the laws and procedures in your state and will be able to advise you.

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

Do not change the ownership of these to your living trust. You can name your trust as the beneficiary, but be sure to consider all your options which could include your spouse; children, grandchildren or other individuals; a trust; a charity; or a combination of these. Whom you name as beneficiary will determine the amount of tax-deferred growth that can continue on this money after you die.

Most married couples name their spouse as beneficiary because 1) the money will be available to provide for the surviving spouse and 2) the spousal rollover option can provide for many more years of tax-deferred growth. (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.) A nonspouse beneficiary can also inherit a tax-deferred plan and roll it into an IRA to continue the tax-deferred growth, but only a spouse can name additional beneficiaries.

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 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, distributions will be based on the life expectancy of the oldest beneficiary of the trust. You can also set up separate trusts for each beneficiary so that each one's life expectancy can be used.

The rules for these plans have recently been made simpler, but it is still easy to make a costly mistake. 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 you think this might apply to your situation, be sure to check with your tax advisor or attorney before you change the title to your trust.

Other assets that should probably not be transferred to your trust are incentive stock options, Section 1244 stock and professional corporations. If you 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 (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 for instructions.

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 and Section 1244 stock
- Interests in professional corporations
- Funding real estate into a living trust is state specific and may not apply in all states.