TRUST FUNDING: BEST PRACTICES

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A. Introduction

Many Trust and Estate attorneys spend significant time and resources assisting clients design revocable trust-based[1] plans to accomplish a variety of goals. Most of the basic reasons for using trusts assume that these trusts will actually be used to hold or own client assets. Over the past several decades, the trust planning practice has undergone significant changes. Trusts are now used by many different types of clients to accomplish different goals. But the basic premise behind trust-based planning has not changed: in order to accomplish client goals, the client's trust needs to own the particular assets which the trust was designed to hold.

B. Why grantors use trusts

Most clients have the same estate planning goals: ensuring that (1) they keep control of their assets during their lifetimes, and are able to care for themselves and family during incapacity; (2) post-death gifts are given only to specifically designated beneficiaries, either outright or in further trust, and with appropriate restrictions; and (3) at the end of the administration process, administration is simplified and legal and accounting fees are reduced. Ensuring that a trust is "funded" accomplishes these goals.

1. Avoiding probate

Trust-based planning became popular for non-high net worth clients in the early 1960s, when attorneys, and promoters of trusts, designed trusts to work outside the probate process. Trusts are private agreements between grantors and trustees (often the grantor is the trustee), designed to create private administration of assets post-death outside of probate.

However, with the advent of the Uniform Probate Code, states which adopted the UPC or similar laws simplified and streamlined the probate process. Informal probate in Colorado under the UPC is often outside of court, or informal, and except in limited circumstances need not be supervised by a court. Further, bond is usually waived when requested in a will.

Most parts of post-death trust administration may safely bypass probate administration in Colorado. But in order to achieve this outcome, Planners must ensure that their clients' trusts own

[1] This discussion relates to revocable trusts, which are grantor trusts under IRC § 676, where the assets of the trust are included in the grantor's taxable estate under IRC § 2038 at death by reason of the grantor's lifetime right to revoke the trust.

their assets at death. This requires "funding" assets into a trust at its creation, and exercise of diligence in ensuring that later acquired assets are also funded into the trust.[2]

Where a trust is not fully funded at death (i.e., the grantor owns assets personally outside of the trust), assets can be transferred to the trust, if a grantor's will includes a "pour over" clause. This clause instructs the Personal Representative (or "PR") to "pour" assets to the grantor's trust to be administered out of the trust. However, trust funding at death through a pour over clause requires some probate administration of assets before the assets can be administered out of a trust.

Under C.R.S. § 15-12-1201, if the total value of estate assets is $80,000 or less, then the assets may be administered with a "Small Estates Affidavit".[3] However, in cases where a grantor owns property in excess of this limit in his estate, and not in his trust, some probate administration will be required. For example, if the grantor individually owns real property located in Colorado, letters testamentary must be obtained and the property then transferred by the PR to the trustee of the grantor's trust.

In some cases, this post-death probate transfer funding might defeat a grantor's intentions. For instance, if the grantor is survived by estranged children, those children are notified of the commencement of the probate, and on that basis might challenge the trust administration of the asset, even if such children have no right to the property through the trust.

If the grantor's real property is personally owned and situate outside of Colorado, at a minimum in most states an ancillary probate must be commenced to probate the property and transfer it to the grantor's trustee, significantly increasing administration costs.

Thus, only a fully funded trust truly avoids probate administration.

2. Ensuring private administration of assets

Many clients prefer to have their property administered privately at their death. At the death of Charles Boettcher in 1948, local news reports stated that his "Estate" owned a vehicle and a few thousand dollars. Of course, most of his assets were privately administered in his trust, which owned those assets at his death. Likewise, other famous cases suggest that when administration an estate is public, through the probate process, conflict often increases (for legally strategic reasons) and client goals may not be accomplished. A well drafted trust will ensure a private administration process, limit beneficiary and family conflict, and ensure that disputes are resolved privately.

3. Comprehensive management of assets

Modern trust clients often own a variety of different assets, such as real property, brokerage accounts, insurance policies and IRAs. It is possible to own these assets in a manner that may avoid probate administration of such assets at the owner's death. For instance, real property and

[2] "Funding" a trust simply means that an asset is transferred to or titled to a trust.

[3] For further discussion see Bette Heller, The Affidavit for Small Estates: How, When and Why to Use It, 46 Colo. Lawyer 43 (June 2017).

brokerage accounts can be owned in joint tenancy. Naming a beneficiary on an insurance policy and/or retirement account allows the proceeds to transfer the named individual beneficiaries upon the principal's death.

However, in a joint revocable trust created by spouses, these techniques usually are not helpful. Often a surviving spouse is the intended beneficiary of such assets and will need these assets during her life. Thus, such assets are typically owned by or transferred to the spouse's joint trust, and do not pass to the survivor in a nonprobate transfer.

A trust often offers the best method to comprehensively manage a grantor's varied assets.

4. Trusts distributions for care of grantor or family, during incapacity

Planners often advise clients that trust based planning is the "gold standard" for incapacity planning, allowing a grantor to describe his desired care and have assets available to provide for his care and his family's needs during any incapacity.

In the unlikely event of a common accident, where a surviving spouses may be incapacitated, or the more common scenario where a surviving spouse becomes incapacitated in aging, assets must be funded at trust creation, and throughout the grantor's/grantors' lifetime, in order for the trust to serve the grantor's needs during incapacity.[4]

There may also be conflict between an agent under a durable power of attorney or a conservator, and a successor trustee. The end result may be that the type of care the grantor intended for himself and his family may not be accomplished.

Further, when a family discovers that certain assets were never transferred to trust during life and are not owned in trust at a grantor's death, they may wonder why a grantor used a revocable trust, and may seek to avoid transfers to the trust, the result of which may be to defeat a grantor's intentions.

To accomplish a grantor's incapacity planning, his trust must be funded.

5. "Dead hand control"

Certain beneficiaries may have special needs or limitations which may require that any gift be administered by a trustee over time, consistent with the intentions of the grantor. Distributions may involve either principal or interest, as well as discretionary distribution standards consistent with the grantor's intentions and the needs of the beneficiary. Some beneficiaries will do well with liberal distribution standards, but others may need conservative distribution standards based on their needs or limitations. Other beneficiaries may benefit from specific incentives. These tools are only available when assets are administered using a trust.

6. Reducing administration costs

[4] A durable power of attorney giving an agent the power to make such transfer is often used as a secondary funding tool.

In cases involving complex or varied assets, special beneficiary needs or provisions for beneficiaries, providing such designations in a trust will be more cost effective to administer over time. Further, the Colorado Uniform Probate Code and the Colorado Uniform Trust Code permit designation of private dispute resolution as an option to avoiding trust and probate litigation.

When assets are not owned in trust at a grantor's death, the private administration of assets could become public, allowing beneficiaries to contest the grantor's intention in a probate court. More often, the failure to fund assets into a trust during a grantor's lifetime may result in parallel administrations, first in the probate court, and thereafter through the trust terms, which may significantly increase administration costs and delay the entire process.

Likewise, when assets are not transferred prior to grantor's incapacity, administration may result in conservatorship administration of such assets. The cost and complexity of a conservatorship is something the grantor expected to avoid when he created his trust. This risk should remind Planners that funding is a continuing process through a grantor's lifetime.

C. When trust funding may not be the best solution

There are cases when trust ownership of an asset may not be the best solution. The Planner needs to evaluate client case and each asset to consider whether trust ownership best accomplishes client objectives. Different methods of transfer and ownership may be appropriate depending on each case.

1. <u>"Daily" accounts and jointly owned accounts</u>

Many clients have "daily" checking accounts, which may be owned outside a trust for specific purposes, such as ordinary living expenses. Other grantors may own an account with a spouse or a child, and joint tenancy may accomplish the client's goals.

There are also instances where control of an asset is needed by an individual outside a trust, such as a bank account needed for a specific purpose, and thus it may be best not to title that account to a trust. However, when planning is for a single grantor, those assets should be made payable to the trust at death unless the client wishes to pass the asset outside of her trust.

Each client's situation is different, and the value of the Planner is in the skill in addressing funding specifics for each individual asset owned by the client.

2. <u>Control situations</u>

Some married clients own separate property which they want to keep separate, for instance property acquired before marriage, which might best be owned outside a trust (including in the case of a joint trust, discussed below). Some clients wish to pass certain property, such as inherited property, to a particular family member, and ownership outside of trust may be the best method to transfer ownership.

Other cases may involve client preferences, where a client sees the value of owning assets in trust, but has specific preferences relating to certain property. Planners should seek to accomplish client goals taking into account such preferences.

3. Securities (stocks, LLC membership interests and partnership interests)

Clients often own interests in a business with other owners, where administration of such interests under trust ownership during a client's lifetime may not be practical. In other cases, partnership or LLC interests, or stocks, may be subject to transfer restrictions, In both cases, a "post mortem" assignment ("PMA") of the asset at death may be an appropriate method to fund the asset into the trust at the death of the grantor owner.

Under C.R.S. § 15-15-101(1)

> A provision for a nonprobate transfer on death in an insurance policy, contract of employment, bond, mortgage, promissory note, certificated or uncertificated security, account agreement, custodial agreement, deposit agreement, compensation plan, pension plan, individual retirement plan, employee benefit plan, trust, conveyance, deed of gift, marital property agreement, or other written instrument of a similar nature is nontestamentary.

Under this statute, money or benefits due to, controlled by or owned by a decedent at death must be paid after the decedent's death to any person designated in a writing by the decedent to receive that property. A trustee of a revocable trust may be the designated beneficiary of such property. Further, property passing under a PMA is a nonprobate asset.

Thus, an LLC co-owner of a small business may designate her trustee to receive the LLC interest at the grantor's death, so that after death the asset will be "funded" into and administered under the terms of her trust. This allows the convenience of managing the asset outside of trust during life but ensures administration of the property in the trust at death.

4. Beneficiary deeds for real property and vehicles

Under C.R.S. § 15-15-401, a property owner may record during her lifetime a "beneficiary deed", which designates a beneficiary to receive real property at the grantor's death. A beneficiary need not consent to the deed. However, the beneficiary has no right to the property until the owner passes, and the owner retains full ownership until death. Further, the grantor may be revoke the deed after recording prior to her passing.

Beneficiary deeds may be used by grantors for property held outside of a trust. For example, as discussed above, there could be certain real property that a grantor wishes to pass outside of trust, such as inherited property. A beneficiary deed is effective to transfer the property at death, and so avoids all administration, probate and trust.

Recently, the Colorado Legislature approved a "beneficiary deed" process for vehicles. Under C.R.S. § 42-6-110.5, a vehicle owner can designate a recipient of her car at her death, on Department of Revenue form DR 2009, and after her death the vehicle will be transferred to the

designated beneficiary by presenting the form and DR 2395 Application for Title to the Department of Motor Vehicles. As with beneficiary deeds, some clients may prefer the ease and speed of this process for transferring vehicles at death.

5. Medicaid eligibility

For clients concerned about a surviving spouse being able to qualify for Medicaid and desiring to leave a special needs trust for that spouse, the grantor must direct such a testamentary trust be created for the surviving spouse under the grantor's Will and not from a revocable trust. In Skindzier v. Comm's of Soc. Servs., 784 A.2d 323 (Conn. 2001), a trust created by the Will of a deceased spouse for the benefit of the decedent's institutionalized spouse was not considered a disqualifying asset of the surviving spouse under Medicaid law. Where a client has such a concern, the grantor's successor trustee at death can be directed to create a testamentary trust under the decedent's Will if, at the decedent's passing, the surviving spouse is disabled or eligible for government benefits such as Medicaid or Supplemental Security Income.

6. Separating a deceased grantor's trust property in a separate share

Joint trusts are a commonly used planning tool for married grantors who have the same sources of wealth and the same children or objects of affection. In such cases, Planners often fund property owned by both spouses into a single joint revocable trust. The considerations in using a joint trust are beyond this article. [5]

Some joint revocable trusts provide for funding all assets in the revocable trust in a "marital" or "survivor's" share after the death of the first grantor. It may be prudent to hold the deceased grantor's separate property and its income in a separate share, at least where the joint revocable trust is the beneficiary of the deceased grantor's qualified plan benefits. The purpose of the separate share is to keep the deceased grantor's trust property and its accumulated income separate from the marital share during the lifetime of the surviving grantor spouse, so that the separate share can qualify as a designated beneficiary and avoid possible disqualification of the federal estate tax marital deduction under IRC Section 2056.

7. Other relevant considerations

As discussed above, the Planner needs to incorporate the funding into the entire planning process. Of course, it is impossible to consider the effect of trust terms without considering the property which may be administered through the trust.

For each client, the Planner should consider which assets should be funded into the trust. Similarly, in considering how to accomplish each client's goals, the Planner must consider which assets should not be titled into the trust.

[5] For a thorough discussion, see Heller, Ransford and Stevens, Joint Revocable Trusts, 26 Colo.Lawyer 63 (August 1997).

For stable long married clients, funding certain assets into a joint trust, such as property inherited by one spouse, may be acceptable to both clients. The Planner must explain the benefits and disadvantages of such planning, without becoming an advocate for either client.[6]

Planners also must be careful in counseling use of a joint trust for remarried clients or blended families, discussing the advantages and disadvantages of using a joint revocable trust and funding separate property into the joint trust. In such cases, the trust must carefully address how the property is to be administered in case of future divorce.

D. Funding specific assets

The Planner must also consider the form and details of transfers.

1. Real property

Funding homes owned jointly by a married couple into a joint trust is common. Under Garn St. Germain, 12 USC § 1701j-3(d)(8), property transfers to revocable trusts are exempted from due on sale clauses.

Further, many lenders will allow clients to refinance properties owned in revocable trusts with presentation of an "attorney letter" confirming the revocable nature of the trust.

In rare cases, Planners may need to review title to ensure that a transfer of title to a trust does not create or involve marketability issues.

2. Personal property

The Planner should also discuss funding personal property into the trust. Personal property may be transferred to the trust via a general assignment of all the grantor's personal property. In such case, administration of the personal property at death is within the trust, and thus avoids estate administration of such assets.

In some cases, as discussed above, such as inherited property owned by a married grantor, it may be best to not fund such asset into the trust but instead pass the property at death using a different method. Alternatively, a grantor can fund such property into her trust but then designate the property to pass to a specific person using a personal property memorandum. See C.R.S. § 15-11-513.

In families with potential for conflict where general assignment funding of personal property is used, the Planner should encourage the client to execute a general assignment periodically to ensure transfer of later acquired personal property.

3. Brokerage accounts

[6] For a discussion of ethics relating to joint representation, see ACTEC Commentaries on the Model Rules of Professional Conduct (4th Ed. 2006), MPRC 1.7: Conflict of Interest: Current Clients (91-92 and 105 (Joint Representation: Disclosures)

Planners should contact a client's financial planner, to incorporate these professionals into the process and use their resources for funding when available.[7]

4. Insurance policies

Trusts are commonly designated at the beneficiary of an insurance policy death benefit. Funding benefits into trust at a grantor's death ensures that the liquid value of the policy proceeds are administered under the terms of the trust and are immediately available for a surviving spouse and other beneficiaries.

5. Securities (stocks, LLC membership interests and partnership interests)

As discussed above, Colorado law allows a trust to be designated as the payee of a property or beneficial interest at the death of the owner of such asset.

6. 529 accounts

Most state qualified tuition programs permit a trust to be an account owner of a 529 plan. Typically a trustee opens an account, with the trust as the account owner, and an individual person (usually a trust beneficiary) is designated as the beneficiary of the 529 account. Thereafter, the terms of the trust control distributions from the 529 account.

7. Qualified plans

Planners may use a "conduit trust" strategy for funding of qualified plans, where a revocable living trust is designated as the secondary beneficiary, behind a spouse, of an IRA.[8] In such case, it is critical that the Planner carefully review and approve each designation form to ensure all entries are correct.

E. Creating an effective funding process

Every Planner committed to and practicing trust funding can establish an effective process. Several basic steps are suggested.

First, each client should complete a comprehensive worksheet identifying their assets and form of ownership. Modern firms are using online fillable forms. New practice tools also accommodate automatic migration of client data into spreadsheets and lists. Planners should create forms for

[7] Financial planners are a good source for referrals and often will prepare title transfer forms for a Planner.

[8] Using this technique, a spouse designates her spouse as the primary beneficiary and if he survives her, he can use the beneficial "spousal rollover rules". At the death of the survivor, a grantor's child's share of an IRA may be held as an asset of a subtrust created for the child beneficiary. A full discussion of this technique is beyond this article. For more, see Natalie Choate, Life and Death Planning for Retirement Benefits, Chapter 6 (2021); and Kavesh, Proper Post-Death Administration of an IRA Beneficiary Trust, Ultimate Estate Planner (2012).

both married and single persons. These forms should also be periodically updated to accommodate the Planner's practice and increasing experience and knowledge.

The process should advise clients that the Planner needs the asset information to effectively interview and serve the client. Planners can send scheduling emails with links to forms and calendar invites to create a modern, streamlined client-focused experience.

In the client's "design" meeting, Planners should use the worksheet asset information to "design" the grantor's trust, showing the grantor how the assets will be initially funded or titled into the trust; administered during the grantor's lifetime; held and used during incapacity; transferred at the death of the grantor or his spouse; and administered post-death for the benefit of family or other beneficiaries, either outright or in "subtrusts" (also called "fbo" or "following" trusts).

Following this meeting, the Planner should create a "funding" list and identify those assets which will be titled to/funded into the trust. The list should also include other client assets not to be funded into the trust, and identify how those will be held (e.g., individually, tenant in common or post-mortem assignment).

At closing the Planner should provide the client a "funding notebook", including a copy of the final funding list and copies of the "funding" or title transfer documents signed by the client to accomplish the funding designed by the Planner.

At closing, Planners can have clients sign their planning documents, as well as all title/transfer documents. Clients should be advised to review future account and property statements, to ensure that the titling reflects the funding agreed to by the client. In certain cases, where Planners are asked to, or need to, give specific funding instructions to a client, those should be included in a closing letter that includes such details. A good closing notebook will include information instructing clients how to maintain their trusts.

By incorporating asset information in the design phase, showing the client how assets will be owned as well as administered by the Trust, and discussing the details of funding at closing, the Planner will accomplish effective trust funding and educate the client regarding the ongoing funding process.

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