Funding Your Trust from A to Z

INTRODUCTION

You have executed a living trust as a part of your estate planning. In order for your trust to continue to meet your planning goals and to avoid probate of your assets, it is critical that your assets be titled in the name of your trust. The process of transferring your assets into your trust is called "trust funding." The purpose of this Memorandum is to increase your understanding of what actions we are taking to fund your trust.

Your trust has its own "legal" name. The legal name of your trust must state the names of your trustees, who created the trust, and the date the trust was signed. We will use the following name for purposes of beneficiary designations and transferring ownership of assets into your trust:

> **WILLIAM A. SAMPLE and MARY A. SAMPLE, Trustees, or their successors in trust, under the WILLIAM A. SAMPLE LIVING TRUST, dated November 13, 2017, and any amendments thereto**

or

> **MARY A. SAMPLE and WILLIAM A. SAMPLE, Trustees, or their successors in trust, under the MARY A. SAMPLE LIVING TRUST, dated November 13, 2017, and any amendments thereto.**

FUNDING VARIOUS TYPES OF ASSETS

Different types of assets are funded in different ways. The following section will outline the general funding procedures for a variety of asset types as well as some special issues that you should be aware of. You may not own all of the assets identified below; however, we have included a summary description of each asset type as an aid for you should you acquire a new type of asset that you have not previously owned.

CASH ACCOUNTS

In General: Cash Accounts would include bank and credit union accounts. They are funded by initially contacting the financial institution and requesting that title to the account be changed to the name of the living trust. Although each institution has different internal procedures for changing title, most institutions will require that the change of ownership be noted on a signature card.

Opening/Closing of Accounts: Note that some institutions may require that the original account be closed and a new account be opened, while other institutions will simply change the name on the original signature card to reflect the new ownership in the trust.

Loss of Privileges: In the past, it was common practice in the banking industry to restrict senior citizen discount privileges, ATM privileges, free checking privileges, and the like for accounts held in trust ownership. Prior to funding any cash accounts, we will verify that there will not be any loss of account holder privileges as a result of the transfer.

Imposing a Penalty: Some banking institutions may impose a penalty for transferring a certificate of deposit (CD) prior to its maturity date. Generally, the branch manager has authority to waive the penalty. Prior to funding any CDs we will verify that there will not be any penalties or loss of interest imposed as a result of the transfer.

Printing the Name of the Trust on Checks: Most institutions will provide their customers with a substantial degree of latitude as to what information is printed on the face of their checks. There is no legal requirement that the name of the trust be printed on the checks. Many Trustmakers would prefer not to disclose the nature of their estate planning on the face of their checks. Additionally, people in the business world may become confused as to whether they can accept a check that reflects the ownership as a trust. (Note there is no legal reason why they could not and this is becoming much less of a problem as the use of Living Trusts continues to become more widespread).

Automatic Electronic Deposits/Withdrawals: Before funding any accounts, we will inquire as to whether there are any automatic electronic deposits or withdrawals associated to the account. These would include direct deposit of Social Security, Pension and Payroll checks, mortgage and home equity line of credit payments, and debit cards. Should any of these types of transfers occur, we will recommend that you allow us to open a new account and transfer the electronic transfers to the new account number. We recommend that you keep both accounts open concurrently for 30 to 60 days until the new electronic transfers are established and verified.

Tax Payer Identification Number: Occasionally, institutions will ask for verification of the tax payer identification number prior to effectuating the change of ownership. Under the Treasury Regulations [Tres. Reg. 1.671-4], the Trustmaker is required to use their social security number as their tax payer identification number so long as:

- the trust is revocable;
- the Trustmaker is one of the trustees; and
- the Trustmaker is not disabled.

If all of these conditions are met, the Trustmaker can satisfy the transfer agent by completing a W-9 form. We will prepare then necessary tax forms to satisfy each institution's requirements.

Maintaining an Account in Joint Tenancy: Some attorneys have recommended that married clients maintain a checking account in joint tenancy. This can be a dangerous practice as you could potentially lose control of the asset in the event either joint owner becomes incapacitated. Additionally, assets in the account could potentially lose benefits pertaining to estate tax planning, creditor protection planning, or bloodline protection. Attorneys that recommend this practice also counsel their clients to maintain a relatively small amount in the account. Often, these same attorneys have been surprised on the death of a client that there had been a substantial amount of assets deposited in the account with the intention that it would only be for a short period of time!

Credit Unions: Credit unions have traditionally been a thorn in the side of many funding coordinators as they have often refused to transfer ownership of accounts to a revocable living trust. Often, the credit union's charter specifically restricts them to titling accounts only in the name of individuals. Should this problem arise, there are several different approaches to funding the credit union account that we can explore at that time.

FDIC Insurance: Please note that you will not lose any of the benefits associated with the FDIC insurance coverage. In fact in some situations, changing the ownership of your bank account to the name of your trust may actually increase your amount of FDIC insurance coverage.

INVESTMENT ACCOUNTS

In General: Investment Accounts would include mutual funds, cash management accounts, and the like. They are funded by initially contacting the financial institution and requesting that title to the account be changed to the name of the living trust. Although each institution has different internal procedures for changing title, most institutions will require that change of ownership be completed by submitting a Change of Ownership form to the institution.

This form may be a pre-printed form issued by the institution or it may simply be a letter signed by you authorizing the transaction. No matter what the format, most institutions will require the form be either witnessed, notarized, or medallion signature guaranteed.

Opening/Closing of Accounts: Like Cash Accounts, some institutions may require that the original account be closed and a new account be opened, while other institutions will simply change the name on the original account to reflect the new ownership in the trust.

Automatic Electronic Deposits/Withdrawals: As with Cash Accounts, we will inquire as to whether there are any automatic electronic deposits or withdrawals associated to the account. We will exercise care to ensure that all electronic transfers are coordinated with the new change of ownership on any of your Investment Accounts.

Medallion Signature Guarantee: Some institutions will require any change of ownership forms or instruction letters be Medallion Signature Guaranteed. Only financial institutions can participate in the Medallion Signature Guaranty program. If this is a requirement, we will make the necessary arrangements to secure this special type of signature acknowledgment.

STOCK

In General: Stock certificates that a person holds in their individual capacity are generally funded by either retitling the stock in the name of the trust or by adding a *Transfer on Death* designation to the stock so that it passes to the trust on death. If a person holds their stock in a brokerage account, then the assets are funded in accordance with the instructions above on *Investment Accounts*.

Changing Ownership vs. Transfer on Death Designation: Perhaps the most conservative method of funding stock certificates is to formally change the ownership of the stock to the living trust. A *Transfer on Death* (TOD) designation will result in the certificates being retitled after death and generally should not trigger a probate proceeding to effectuate the transfer. However, a major limitation of a TOD designation is that it provides no protection for the client in the event of the client's incapacity. A financial power of attorney may help to render some protection in the event of a disability, provided the transfer agent accepts the power of attorney.

Steps in Changing Ownership of Stock: The steps in changing the ownership of stock are as follows:

1. Identify the transfer agent

2. Prepare a stock power naming the trust as the new owner

3. Prepare an instruction letter to the stock transfer agent

4. Prepare a W-9 verifying the taxpayer identification number for the trust as new owner

5. Secure a guaranty of the owner's signature on the stock power

6. Send the signature guaranteed stock power and stock instruction letter to the transfer agent.

Accepting Custody of a Client's Stock Certificates: In order to retitle stock, it will be necessary to send the original stock certificates to the transfer agent. Thus, it will most likely be necessary for us to accept custody of your stock certificates.

To avoid later confusion regarding what documents we have taken possession of, a receipt will be given to you that clearly identifies what documents we have received from you. Once the stock certificates have been retitled, it will be imperative that you confirm that the correct number of certificates and shares that you receive.

Time Expectations: The time it takes to receive a re-issued stock certificate will vary from transfer agent to transfer agent. On average, it will generally take anywhere from 30 days on the short end to as long as six months to receive the re-issued stock certificate. This can be a particular problem should you become disabled or pass away prior to receiving the retitled certificates. For this reason, we strongly encourage you to consider opening a street account to hold the certificates. Once you have signed the application to open the street account and have signed the stock power, the stock is considered funded, thus eliminating a lengthy funding delay.

Opening a "Street Account": A *street account* is an account opened with a brokerage firm that physically holds the stock certificates. There are several benefits to opening a street account.

1. Most brokerage firms consider the stock to be in the name of the trust on the same date that they take physical possession of the stock certificates.

2. The brokerage firm will provide periodic statements tracking the current value of the stock as well as any stock splits that may occur. This will be helpful in calculating any capital gains tax liability should the client decide to sell the stock at some future date.

3. The brokerage firm may offer additional services such as credit card, debit card, or ATM cards that would allow the client to borrow against the value of the stock at competitive interest rates.

INCENTIVE STOCK OPTIONS

Background: Incentive Stock Options are a type of benefit offered by corporations to their employees. These options are provided for in the Internal Revenue Code Section 422 and they receive special tax treatment if the statutory rules are followed.

If an employee meets the requirements established by Congress for this program, then the employee does not recognize any income for the difference in the price he paid and the fair market value of the stock on the date the employee pays for the stock at the option price. As a result, the employee will then have low basis stock, but it will be eligible for capital gains treatment when later sold. This can be a significant benefit for highly compensated individuals.

The two issues that you need to be concerned about are the requirement that the options be exercised within a ten year period and that your funding plan does not cause a "disqualifying disposition".

Requirements: One of the requirements to receive the special tax break is that the stock be held for specific periods of time. The stock can not be disposed of within two (2) years of the granting of the option nor within one (1) year of the transfer of the shares to the individual. For example, if you are given an incentive stock option on June 1, 1997, and you "exercise the option" on January 2, 1999, the earliest you can dispose of the stock without violating this rule is January 2, 2000.

When people talk about "exercising their options," it simply means that they are going to buy the number of shares their option allows them to purchase at the price set in the option. It is the fair market value of the stock at the date the option was granted. Clearly, options only are exercised when the current stock price is higher than the option price.

Titling when using revocable living trusts: The regulations discussing dispositions do not cover transfers to revocable trusts. However, there are several private letter rulings that have addressed the issue since 1990 and all have reached the same conclusion. The retitling of the stock or the option into the employee's and the co-trustee's name is <u>not</u> a disqualifying transfer, so long as the following requirements are met:

1. The trust is a grantor trust (i.e. a revocable living trust) under the Internal Revenue Code; <u>and</u>

2. The employee is either the sole trustee or one of the co-trustees; <u>and</u>

3. The employee has the right to revoke the trust during employee's lifetime.

CAUTION - When Equalizing Estates: When deciding which assets to allocate in separate trusts, extreme caution needs to be exercised in dealing with these options. During this time it is suggested that you **do not** use these shares to equalize the assets during the "one-year after exercise or two years after grant period." Once you are outside of this period, then the stock can be shifted to other individuals, trusts, or entities because the stock is then treated like any other stock.

<u>BONDS</u>

In General: There are a number of different types of bonds. The U.S. Treasury Department issues bonds in Series such as E, EE, H, HH, & I bonds. Municipalities and school districts can also issue bonds.

Funding Series E, EE, H, HH & I - U.S. Savings Bonds: U.S. Savings Bonds are funded by preparing a form called a *PDF 1851*. Note that this form needs a Medallion Signature Guaranteed in order for it to be accepted by the U.S. Treasury Department.

Income Tax Issues: Funding U.S. Savings Bonds needs to be done with extra care to avoid acceleration of income tax. The IRS has ruled that transferring a U.S. Savings Bond into a revocable living trust is not an income taxable event **so long as** the bonds were transferred to the trust of the maker that provided the proceeds to purchase the bonds. If the bonds were not originally owned by the Trustmaker, an acceleration of the accrued income will occur and you will be obligated to pay additional income tax. Several common examples where the accrued income will be accelerated are:

1. Where only one spouse owned the bonds and they are subsequently transferred to a joint trust;

2. Where Spouse #1 originally owned the bonds and they were transferred to Spouse #2's separate trust;

3. Where both spouses originally owned the bonds and they were transferred to either spouse's separate trust.

4. A parent or grandparent purchased the bonds and named the client as a co-owner.

Confirming Accuracy of Funding: Note that it is not uncommon for the Federal Reserve Bank to misplace some of the bonds that we have sent them for retitling. Additionally, it is not uncommon for the Federal Reserve Bank to return the bonds to you in two or more shipments. We will exercise additional care to assure that all of the bonds you have provided us for funding have in fact been received.

Municipal Bonds, School District Bonds & Capital Improvement Bonds: Ownership of these types of bonds is usually evidenced in the form of a *Bond Certificate* that is similar in appearance to a stock certificate. Funding these types of bonds is done through the use of a *bond power*. The bond power will generally need to be Medallion Signature Guaranteed in order to be re-titled.

PERSONAL EFFECTS

In General: Personal effects are often overlooked in the funding process. Yet many people hold a substantial amount of wealth in personal effects. The process of funding personal assets is a relatively easy process.

What are Personal Effects: Personal effects can include such things as jewelry, appliances, tools, furniture, clothing, china, silver, coin collections, works of art, and the like. Actually, any tangible asset that you own is considered a personal effect. The problem with funding these types of assets is the lack of documentation evidencing ownership. When a person buys a new refrigerator or a new set of power tools, they do not receive a deed as they did when they purchased their home or a certificate of title as they did when they purchased their automobile.

How to Fund Personal Effects: Funding personal effects will require using one of two different types of documents. For assets of substantial cash value, a Bill of Sale of Specific Property is utilized. For all other personal assets, a Generic Bill of Sale is utilized.

Specific Bill of Sale: For assets of substantial cash value, such as jewelry, coin collections, works of art, and the like, a Specific Bill of Sale may be preferred. A Specific Bill of Sale identifies an individual asset that is to be funded. Although a Generic Bill of Sale would probably be sufficient to complete the funding, using a separate Specific Bill of Sale may help to eliminate any confusion or reduce the risk of a potential postmortem challenge to the validity of the funding.

After Acquired Property (Property Purchased After Signing the Bill of Sale): The Generic Bill of Sale contains a clause known as an *"After Acquired Property"* clause. This clause provides that the Bill of Sale applies to any new assets you acquire after signing the Bill of Sale. Not all states recognize the validity of *After Acquired Property* clauses. For this reason, it is prudent practice to sign a new Bill of Sale on a regular basis.

Automobiles, Boats, Trailers, Campers, Motorcycles and RVs: Assets such as automobiles, boats, motorcycles, and the like should not be funded with a Bill of Sale. Retitling the vehicle is the way to fund these assets. If the vehicle was financed and an outstanding balance remains on the loan, then the certificate of title will reflect the existence of the loan and the vehicle will generally not be able to be funded until the lien is removed.

Special Issues Pertaining to Antique Automobiles and Trailers: Both trailers and antique automobiles may not have a certificate of title. Should no certificate be available, a Specific Bill of Sale should be used.

Notice to Property Casualty Insurance Company: Automobiles are often covered by an insurance policy that protects against theft, loss, or liability. Typically, these types of insurance policies, called property and casualty (P&C) policies, are purchased in the name of the client and provide insurance coverage so long as you own the asset. Many legal commentaries have been concerned that an insurance company may attempt to dishonor the policy if the asset is transferred into the name of their revocable living trust.

As a precautionary measure, we will send a letter to your insurance agent asking them to name the trust as an additional insured. Generally, there should not be any additional premium for adding the trust as an additional insured.

RETIREMENT PLANS & PENSIONS

In General: Qualified retirement plans ("Plans") and IRAs are special types of investment accounts that grow income tax deferred until the plan proceeds are withdrawn. Over time this special tax deferred treatment yields tremendous growth in the plan. We will exercise special care funding Plans and IRAs to ensure that ownership of the Plan is not transferred to your Living Trust. The IRS will treat a transfer of a Plan or IRA to a Revocable Living Trust as a distribution, and the full value of the plan will be treated as ordinary income. Therefore, the preferred method of funding Plans and IRAs is to name the trust as either the primary or contingent beneficiary of the plan.

Should the Trust or the Spouse be the Primary Beneficiary: For years, commentaries have been debating the merits of naming the spouse or naming the trust as the primary beneficiary of the Plan or IRA. There are several schools of thought on the issue. In either case, the primary beneficiary can disclaim the Plan or IRA benefits to the contingent beneficiary on the death of the participant. However, there are advantages and disadvantages to both methods. A proper decision can only be made after we have ascertained your goals and objectives and after we have reviewed the Plan or IRA to ascertain the available funding options.

INSURANCE

Funding Life Insurance can involve the transfer of ownership of a policy, the change of beneficiary designation of a policy, or both. As a general rule, ownership of a policy is usually changed when the policy has a cash value. By transferring ownership of the policy into the trust, a successor disability trustee could access the cash value or other rights under the policy in the event the Trustmaker was incapacitated.

If there is no cash value in the policy, it may still be a good idea to transfer the ownership of the term policy to the trust. Many term policies allow the policy to be converted to a whole life policy without the need to verify insurability. In the event of the trustmakers' incapacity, if the term policy is owned by the trust, the trustees could exercise the right to convert the policy to a whole life policy.

Ownership of a policy is changed by:

1. Completing the company's change of ownership form

2. Attaching a change of ownership instruction letter signed by the policy owner

Regardless of whether there is cash value, the beneficiary designation is generally changed to name the policy owner's trust as the primary beneficiary. This will allow the insurance proceeds to receive the benefits of estate tax planing, creditor protection, bloodline protection, and values promotion contained in the trust.

Beneficiary Designation is changed by:

1. Completing the company's change of beneficiary designation form

2. Attaching a change of beneficiary designation letter signed by the policy owner

Group Insurance Policies: Many employers provide group life insurance as an employee benefit. If your employer provides such benefits, we will contact your company human resources department for the appropriate forms necessary to change the beneficiary. Generally, the ownership of a group policy cannot be changed. Although most group policies will allow the beneficiary designation to be changed to name the trust.

Funding Disability Insurance: As a general rule, most disability insurance policies do not allow a trust to be named as the beneficiary. This is certainly an odd policy, as it would require the payment of proceeds to be subject to the probate court if the insured is completely incapacitated.

Special Funding Considerations:

Loans Against a Policy: Many policies that have a cash value allow the insured to borrow against the cash value. If a loan has been taken against the policy, the company may not allow the ownership of the policy to be changed to a revocable living trust until the loan is re-paid. Although this restriction may effectively prevent the funding of the policy ownership, most companies will allow for the change of beneficiary designation. If the client is able to repay the loan, they may want to consider repaying it so that it can be re-titled to the trust. If repayment is not an option, then changing the beneficiary designation may not be possible until a later date.

Funding Insurance Policies of Divorced Clients with Minor Children: If you are divorced with minor children from the former relationship, it will be important to ascertain whether the divorce decree requires you to maintain a life insurance policy on your life for the benefit of any of your minor children. This is a common provision in many divorce decrees and is intended to assure that adequate financial resources would be available to support or educate a minor child to emancipation. We will inform you what options are available for funding insurance that is subject to a divorce decree.

Policies that are Collateral for a Loan: From time to time, you may have borrowed money from financial institutions. The loan may take many forms including an educational loan or line of credit. Frequently, financial institutions have required a borrower to assign their life insurance proceeds to the financial institution as collateral for the loan. Transferring the ownership or changing the beneficiary designation may result in acceleration of the loan repayment.

We will need to contact the lender directly to ascertain what actions they will take if the policy is funded. Lenders may allow the loan to be assigned to the trust while other lenders may require the old loan to be replaced with a new loan naming the living trust as the borrower. We will advise you of what options are available.

ANNUITIES

In General: An annuity can be either commercial or private. A *Commercial Annuity* is a contract entered into with a company that sells financial products. The annuity contract of a commercial annuity will provide that the company will be obligated to make payments to the beneficiary for a specified period of time. The time period may begin immediately or it may not begin until some future time. Additionally, some commercial annuities will provide benefits after the death of the owner. Thus, when funding a commercial annuity, both the lifetime beneficiaries and the after death beneficiaries will need to be funded.

A *Private Annuity* is also a contract to make payments for a specified period of time; however, it is entered into between individuals and the payment obligations cease at the death of the recipient. Because payments only occur during the lifetime of the recipient, the private annuity does not have any death benefits that need to be funded. Accordingly, when funding a private annuity, only lifetime benefits can be funded.

Funding Options: Due to restrictions contained in the Internal Revenue Code, changing ownership of an annuity into the name of a revocable living trust is generally not recommended. Many legal commentaries have debated whether a living trust meets the definition of an "individual" under the Code. A recent Private Letter Ruling would support the argument that a trust would qualify. However, Private Letter Rulings are only binding upon the taxpayer that requested the ruling. It may be better to error on the side of caution. The most conservative funding option available is to change the beneficiary designation to name the living trust as the primary beneficiary without changing the ownership of the Annuity

Limitations on Distribution Options: Changing the owner of the annuity to the trust may also impact on what distribution options are available under the annuity contract. Some annuity contracts provide that only a spouse or child of the annuity owner may select between different distribution options. Accordingly, if a trust is named as the beneficiary, the trust may only be able to select from a limited number of distribution options. For this reason, we generally recommend that married clients name their spouse as the primary beneficiary and their trust as the contingent beneficiary.

Annuities that are Collateral for a Loan: Like life insurance, annuities can be used as collateral for a loan. If this is the case, we will follow the same procedures identified under *Life Insurance* above to prevent your loan from being accelerated.

MONIES OWED TO CLIENT

In General: From time to time, it is not uncommon to find that a client has made a loan of money to a child or to a third party. Generally, the debtor signs a promissory not when a loan is made. A *promissory note* is a written contract that specifies the terms upon which the loan will be repaid. Because the *promissory note* is often the only legally binding documentation that evidences the loan, it will be important that the *promissory note* be assigned to the trust. If the *promissory note* is not assigned to your trust, then future loan payments made by the debtor may be subject to probate proceedings in the event of your disability or death.

Funding Monies Owed to Clients When No Promissory Note Exists: Often when a client extends a loan to a child or other family members, the legal formalities of signing a *promissory note* may be overlooked. In this situation, the most conservative method of funding this interest is to create a promissory note that names the trust as the lender. We can prepare a promissory note for you if necessary.

Funding Promissory Notes: A *promissory note* is funded through the use of an assignment. The *promissory note* should be referenced in the assignment and a copy of the original *promissory note* should be attached to the assignment.

Putting the Debtor on Notice: When a *promissory note* is assigned to a trust, it will be important that notice be given to the debtor that they should continue to make payments in accordance with the terms contained in the note. However, the debtor should be informed that future payments should be made payable to the living trust. We will prepare the necessary documents.

Funding Secured Interests: In many circumstances, when money is loaned to a business or an individual for business purposes, you may have received a *secured interest* in the accounts receivable of the debtor or the debtor's business. A *secured interest* is generally recorded and is formal recognition on the part of the debtor. It puts others in the business world on notice that any future financial claims against the debtor will be subordinate to the claim of your client. In order to establish a security interest in an account receivable, there are specific rules that must be complied with pursuant to Article 9 of the Uniform Commercial Code. We will prepare the necessary forms to effectuate the assignment of the security interest.

BUSINESS INTERESTS

In General: The steps necessary to fund a business interest will depend on the type of entity.

Corporations: Corporations are funded by re-issuing the stock in the name of the revocable living trust. It will be important that we verify that there are no restrictions contained in your corporation documents that restrict the change of ownership. For this reason, we would request that you provide us with a copy of your corporate book to ascertain what actions we need to take to effectuate the transfer.

Partnerships: A partnership is funded through the use of an assignment. Like corporations, it will be important that we verify that there are no restrictions contained in your partnership documents restricting the change of ownership. For this reason, we would request that you provide us with a copy of your partnership book to ascertain what actions we need to take to effectuate the transfer.

Sole Proprietorships: A sole proprietorship is funded through the use of an assignment. We will prepare the necessary documentation to effectuate the transfer. Additionally, if you maintain a business liability insurance policy, it will be important that we name your trust as an additional insured. For this reason, we will request that you provide us with information pertaining to your insurance policy so that we can take the necessary steps regarding this policy.

Professional Business Interests: Many professionals (such as doctors, lawyers, real estate brokers, CPAs, etc.) own their businesses in the form of a corporation. Each state has its own laws that regulate both the licensing and conduct of professionals. Many states may restrict ownership of professional corporations to only those individuals that hold the appropriate professional license. There are a number of "special" steps that we will need to take to fund professional business interests depending on the type of professional interest you own. We will review these steps with you if applicable.

REAL PROPERTY

In General: Funding real property is one of the most difficult assets to fund. Generally, real property is funded through the use of a new deed. However, there are countless ancillary issues that need to be considered before you execute a new deed.

Types of Real Property Ownership: Before real property can be funded, it will first be necessary to determine how the property is owned. There are several forms of property ownership that will vary from state to state. In general, ownership can be categorized into single ownership (when only one person owns the property) and co-ownership (when two or more people own the property). There is only one type of single ownership which is called *Fee Simple.* There are multiple types of co-ownership such as *Tenants in Common (T/C)*, *Joint Tenancy with Rights of Survivorship (JTWROS)*, *Tenancy by the Entireties (T/E),* and *Community Property (C/P).*

Single Ownership:

Fee Simple: The highest form of ownership is called *Fee Simple*. This form of ownership occurs when only one person owns the property. When funding real property that is owned in *Fee Simple,* only the person that is the record owner of the property needs to sign the new deed transferring ownership to the revocable living trust. **<u>Note</u>**: If the owner is married, the spouse of the owner may also need to sign the deed in order to release their dower interest. (See discussion of *Dower Interests* below).

Co-Ownership:

Tenants in Common: When two or more people own real property as *Tenants in Common,* they each own a part of the asset. For example, if there are two owners, they may each own 50% of the whole. Each owner is presumed to own a part of the whole. They can give away their part during their lifetime or they may leave their part to their heirs on their death. Any two (or more) individuals can own property as T/C. There is no requirement that the owners be related by marriage.

Property that is owned as T/C will be controlled by the terms in either a will or a trust. For this reason, T/C property is the preferred method of co-ownership for property held between two trusts. For example, the name on the new deed would appear:

An undivided ½ interest to:

JOHN SAMPLE and MARY SAMPLE, Trustees, or their successors in trust, under the JOHN SAMPLE LIVING TRUST dated 1-1-99, and any amendments thereto

AND

An undivided ½ interest to:

MARY SAMPLE and JOHN SAMPLE, Trustees, or their successors in trust, under the MARY SAMPLE LIVING TRUST, dated 1-1-99, and any amendments thereto

as Tenants in Common.

Joint Tenancy With Right of Survivorship: Property that is co-owned by more than one owner in *Joint Tenancy With Right of Survivorship* (JTWROS) differs from T/C property in that both owners of JTWROS property are presumed under the law to own 100% of the asset. Thus, if one owner dies, their interest is terminated and the surviving joint owner (who already owns a 100% interest) becomes the only owner of record.

Legal commentaries have heralded the benefits of JTWROS for years. The primary benefit of JTWROS property is that there is no death probate when the first joint owner dies. However, this argument fails in that the property would be subject to probate on the death of the second joint owner and JTWROS property affords no protection against a disability probate on the incapacitation of either owner. What's worse is that JTWROS property is not controlled by your will or trust, thus most if not all, tax planning benefits will be lost when JTWROS property is utilized. Additionally, there are a number of other adverse tax, creditor, and loss of control consequences associated with JTWROS property. For this reason, JTWROS property should generally be avoided at all costs.

Generally, property that is owned in JTWROS will include language on the face of the deed that says something similar to:

"Jointly, remainder to the survivor of them"

Tenancy by the Entireties: Some states (but not all states) allow for a form of co-ownership of real property called *Tenancy by the Entireties (T/E)***.** It has a survivorship feature similar to JTWROS property; however, there are some important differences. T/E property receives special creditor protection not available for most other forms of ownership. If a creditor seeks to attach the T/E property, they must obtain a judgment against **both** owners. Generally, only a husband and wife can hold T/E property. This form of ownership provides a substantial creditor protection benefit to married couples.

Most state laws provide that transferring T/E property into a revocable living trust will generally cause the property to be considered *Tenants in Common* and the preferential creditor protection will be lost. This problem may be able to be avoided through the use of an unrecorded deed. (See discussion of *Unrecorded Deeds* below).

Maintaining Good Title: When funding real property, it will be important to make certain that the funding process has not adversely impacted on the quality of the title or your title insurance policy. Some title companies have taken the position that transferring your property to your revocable living trust will result in a loss of title insurance coverage. As a precautionary measure, we recommend that you obtain an endorsement to your title insurance policy that names your trust as an additional insured. There may be a nominal cost to secure an endorsement, but it is an expense that is worth spending. We will ascertain what expense, if any, that will be charged for the endorsement prior to recording your deed.

Quitclaim vs. Warranty Deeds: *Quitclaim* deeds have traditionally been the deed of choice for most practitioners when funding real property into a trust. A *quitclaim* deed simply says that the owner is transferring whatever interest they may have (and they don't warrant they have any interest at all) to the new owner (i.e. the trust). Another type of deed is called a *warranty deed*. When a *warranty deed* is utilized, the owner is transferring all of their interest to their trust, and they are warranting that they have the highest form of ownership allowed by law. **In the view of the title insurers with whom we have consulted on this issue, the use of a quitclaim deed to effectuate a transfer to a living trust will likely result in an unintentional voiding of the client's title insurance policy.** For this reason, we will utilize a warranty deed in transferring all property to your trust.

Transferring Encumbered Property: A primary concern when funding real estate is avoiding accidentally triggering a *due-on-sale* clause. A *due-on-sale* clause is a common provision found in most mortgages. Changing the ownership of the property may impair a lender's ability to foreclose on the property in the event of the borrower's default. Transferring ownership of a mortgaged (or encumbered) property will almost always result in accelerating the *due-on-sale* clause contained in a mortgage. To prevent a potential acceleration of your *due-on-sale* clause, we will contact your lender prior to recording any deeds and ask that they confirm in writing that they will not accelerate the mortgage if transferred to your trust.

Out of State Deeds: A deed should only be prepared by an attorney licensed to practice law in the jurisdiction where the property is located. Deed requirements, recording requirements, and title standards vary from state to state. Some states may require a title search before the property can be funded. Other states may impose a transfer tax if the property is funded. In addition, some states have actively prosecuted attorneys for the unauthorized practice of law for preparing deeds in jurisdictions that they were not authorized to practice in. For this reason, we will recommend that if you own property out of state, that local counsel be secured to effectuate this transfer. We can assist you in locating an attorney out of state and will ascertain what the cost will be for the deed preparation. We will secure your authorization prior to retaining the assistance of out of state counsel.

Unrecorded Deeds: There may be some situations when the trustmakers may not want to transfer their property into their trust. As a result, the trustmakers may choose to execute a new deed transferring the property to the trust however opting not to record the deed. **As a general rule, most legal commentaries strongly encourage all deeds to be recorded as soon as possible.**

Situations when an unrecorded deed may be helpful include:

1) When the Trustmaker plans on selling or refinancing the property in the near future. Using an unrecorded deed may expedite the sale or refinance by eliminating the need for the lender to review the terms of the trust.

2) When the property is encumbered by a mortgage with a *due-on-sale* clause that would be exercised if recorded.

3) When the trustmakers want to fully fund their trust but not lose the benefits of the *Tenancy by the Entireties* property. Some commentaries have suggested that an unrecorded deed can be used to transfer the ownership interest into the trust but still maintain the preferential creditor protection of the T/E property. This strategy may be flawed as it may be found to be a fraudulent transfer. Careful attention to your state law will be critically important if this strategy is used.

Requirements for a valid unrecorded deed will vary from state to state. An important requirement that almost all states require is valid delivery of the deed to the new owner. To eliminate a potential challenge to the validity of an unrecorded deed, we will provide the Trustees with a receipt acknowledging their receipt of the deed. The receipt should be stored and maintained during the entire time the property is owned.

Unrecorded deeds present several problems. Probably the greatest obstacle facing the use of an unrecorded deed is the potential that the deed could be lost. If the unrecorded deed is lost, it will not be effective for transferring the property into the trust. Additionally, an unrecorded deed will not allow a successor trustee to control the property in the event of the Trustmaker's incapacity.

Property and Casualty Insurance: When transferring real property into the name of a living trust, it will be important that the property and casualty insurance policy be modified to reflect the name of the trust as an additional insured. Most insurance companies do not charge any additional premium to add a trust as an additional insured. It is important that the insurance company is made aware of the transfer and all requirements for maintaining the policy are complied with.

Homestead Exemptions: Many states provide for *homestead exemptions* that exempt a personal residence from property taxes, creditors' claims, or both. Traditionally, a *homestead* *exemption* was personal to the owner of the property. That is, only the record owner of the property could claim the homestead exemption. Historically, transferring real property into a living trust would cause the property to lose its homestead status. However, most states have passed laws that preserve the homestead exemption when the property has been transferred to a revocable living trust.

Steps in Funding Real Property:

1. Secure most recent recorded copy of deed;

2. Determine current owners and current form of ownership;

3. Ascertain whether the property is your primary residence;

4. Ascertain whether there is an encumbrance against the property;

5. If there is an encumbrance, determine whether there are any exceptions that would allow you to fund the property then notify the lender accordingly;

6. After the lender has agreed in writing not to exercise a *due on sale* clause, have the client execute a new deed;

7. Secure an endorsement to the client's title insurance or title guaranty policy.

8. Determine whether the deed should be recorded and take appropriate steps;

9. Submit a Request to Name Trust as Additional Insured to the Property and Casualty Insurance Policy.

Leases: Funding a lease is done in a similar manner as funding real property. Instead of using a deed, an Assignment of Lease of Real Property is utilized. If the property is encumbered by a lease, there may be provisions within the lease that gives the grantee/lessee various rights (i.e. first right of refusals, etc.) upon the sale or transfer of the subject property. Thus, it will be important that we review the original lease agreement to determine whether any such restrictions exist.

TIMESHARES

In General: A timeshare is a form of ownership in a vacation residence that lasts for a specified period of time. How a timeshare is funded will depend on how the timeshare was created. The best starting point is to examine a copy of all documentation in your possession in relation to your timeshare. An examination of the documents should identify how the timeshare was created.

Types of Timeshares: Timeshares are created in one of three different methods; by license, lease, or deed.

Ownership by License: Ownership of a timeshare created by a license typically gives the owner the right to use a vacation unit at a specific resort during predetermined times during the year for a specified period of years. Some license agreements may require the consent of the company that owns the resort to provide written consent in advance of any assignments. You are most likely not the first owners that have requested to fund their timeshare. Your resort company may even have a standardized form to change the ownership. If not, we will create a standardized Assignment of Timeshare License.

Ownership by Lease: Ownership of a timeshare may also be created by a lease. The primary method of funding this type of timeshare is through an Assignment of Lease.

1) Again, the starting point will be to obtain a copy of the original lease;

2) We will check the document to determine whether there are any restrictions that would prevent it from being assigned. Some lease agreements may require the written consent of the company that owns the resort in advance of any assignments;

3) If this is the case, we will contact the resort company to determine what procedures they require and, if necessary, obtain their written consent to the assignment;

4) We will then prepare a new lease that transfers the interest into the name of the trust. If the timeshare is located out of state, local counsel should be secured to prepare the lease and assure that it conforms with all state laws;

5) The lease should be recorded in the county where the timeshare is locate.;

Note that some lease agreements may require that a title search be performed prior to assigning the lease. It is also not uncommon that the lease agreement provides that the title search be conducted by a particular title company. This process can be costly and may cost in excess of a thousand dollars. However, some resort companies will waive the title search requirement if their legal counsel prepares the new lease. Although the cost of their attorneys preparing the new lease may range from $300 to $800, it will still result in substantial savings to the client as opposed to performing a full title search.

Ownership by Deed: Ownership of a timeshare may also be created by a deed. The primary method of funding this type of timeshare is through a new deed.

1) Again, the starting point will be to obtain a copy of the original deed;

2) We will examine the original deed to determine whether there are any restrictions that would prevent it from being transferred. Some deeds may contain restrictions that require the written consent of the resort company in advance of the transfer;

3) If this is the case, we will contact the resort company to determine what procedures they require and if necessary their written consent to the transfer;

4) Then a new deed needs to be prepared that transfers the interest into the name of the trust. If the timeshare is located out of state, local counsel should be secured to prepare the deed and assure that it conforms with all state laws;

5) The deed should be recorded in the county where the timeshare is located.

Note that some deeds may require that a title search be performed prior to signing a new deed. It is not uncommon that the resort company may require a title search be conducted by a particular title company. This process can be costly and may cost in excess of a thousand dollars. However, some resort companies will waive the title search requirement if their legal counsel prepares the new deed. Although the cost of their attorneys preparing the new deed may range from $300 to $800, it will still result in substantial savings to the client as opposed to performing a full title search.

MISCELLANEOUS FUNDING ISSUES

WHEN THEY ASK TO SEE YOUR TRUST

As you put property into your trust and work with it, people in the business world will ask, or even demand, to see a copy of your trust. Since your trust is private, and since it is quite lengthy, it will not be very convenient to let others read or even keep a copy of it. In most instances, people doing business with your trust will be interested in seeing or knowing only a few things about it. They will want to know if it is really your trust, that you are one of its trustees, that you have the authority to act on its behalf, and that it is valid. By giving them a copy of the Certification of Trust, you will satisfy their needs without giving them your trust.

The Certification of Trust will allow you to supply basic information about your trust to others and yet avoid the necessity of furnishing a copy of the entire trust document. It will satisfy everyone that your trust is "legal" without having to read it.

NO NEW TAX IDENTIFICATION NUMBER IS REQUIRED

Because your trust is a revocable living trust, no new tax identification number is required when you transfer your assets into it. You will continue to use your social security number. When transferring securities or other assets into your trust, you may need to sign a Form W-9: *Payer's Request for Taxpayer Identification Number*. This form should be completed using your social security number.

YOUR DEBTS

You will still be liable for your debts regardless of whether you established a trust. A living trust is not used to avoid your creditors, either while you are alive or after you have died; it is used to avoid probate, provide for loved ones, and protect the property you leave to your loved ones from their creditors. When you put your property into your trust, you do not have to put in your debts too.

TRUST TRANSFER DOCUMENTS

You should keep **copies** of all documents which show that you have transferred your property to your trust. We will collect a written verification from each company in the business world that holds your assets. Upon the completion of the funding process, we will send you the original verifications for your records. We recommend that you retain these verifications during the entire period of time you own the asset.

FINAL REMARKS

Please remember that your trust has control over only those assets which have actually been transferred to it. If you need any assistance or have any questions, please do not hesitate to contact us by phone. We will be happy to help you.