

How do you fund a living trust?

Once you have signed your living trust document, the next step is to change titles and beneficiary designations to your trust. This is called "funding" your living trust.

This is probably the most important part of getting a living trust. If you have signed your living trust document but haven't changed titles and beneficiary designations, you've simply wasted your money. You may have a great trust, but until you fund it, it doesn't control anything - because your living trust can only control the assets you put into it.

Remember, when you put assets in your living trust, you do not lose control of them. You can continue to buy and sell assets just as you did before. And anything you put into your living trust can always be taken out later.

In this section, we'll discuss who is responsible for funding your trust, how difficult this process is, and then explain the general procedures for changing titles and beneficiary designations for the most common types of assets people own. We suggest that you look for the ones you own and skip over the others. If you own something that is not included here, your attorney can tell you how to put it into your trust.

WHO WILL FUND YOUR TRUST?

You should know, before your trust is set up, how much of the funding process the attorney will do. Some of the attorneys we know will do **all** the funding. They want their clients' trusts to be as effective as possible, so they personally make sure everything is put into the trust properly.

Usually, however, it is a combination of the attorney doing some and you doing some. Ideally, your attorney should review each asset with you, explain the procedure to you, and together you should decide who will be responsible for each asset. Many attorneys will put your home in your trust for you at no additional cost. Some also have legal assistants who can put other assets in your trust for you at a lower hourly rate than if the attorney does it.

Depending on how much the attorney charges, how comfortable you are with the process, how much time you have, and how interested you are in keeping your costs down, you may want to do many of them yourself.

Most attorneys have pre-written letters you can send to your bank, investment broker, insurance company, etc. that tell them how your assets should now be titled. At the least, your attorney should give you very specific instructions and the exact wording to use for titles and beneficiary designations. The wording will include the name(s) of the trustee(s), the name of your trust, and the date you sign the trust document. So it will be something like this: " John Doe and Mary Doe, Trustees of the Doe Family Trust, dated month/day/year."

HOW DIFFICULT IS THE FUNDING PROCESS?

As you will see in the next few pages, most titles and beneficiary designations are not difficult to change. Some are done by using an assignment, a short (usually one-page) document your attorney will prepare that identifies the asset and states that you are transferring its ownership to your living trust.

Others will require written instructions from you, giving the institutions the exact wording to use on the titles and beneficiary designations (usually the pre-written letters from your attorney will be all you need). Some institutions have their own forms that you will need to complete (for example, life insurance companies have standard forms to change the beneficiary on policies).

Most changes can be handled through the mail and by telephone. Some will require your signature to be notarized or guaranteed (we'll explain who can do this for you).

Even though the process itself is not really difficult, it will take some time. How much time will depend on how many titles and beneficiary designations you have to change and how quickly the institutions respond. Most will be cooperative. However, you may encounter a few people who are still unfamiliar with living trusts. (Since living trusts have become so popular, this doesn't happen as often as it used to.) If you do have any difficulties, usually a quick call from your attorney will clear things up.

If you decide to do most of the funding yourself, we suggest that you make it a priority and keep going until you're finished. Start with your assets that have the largest values, then work down to the smaller ones. Remind yourself why you are doing this - and look forward to the peace of mind you'll have when your living trust is complete.

Now let's look at how titles and beneficiary designations are changed.

HOW TO CHANGE TITLES AND BENEFICIARY DESIGNATIONS

If You Live In a Community Property State

If you live in one of the eight community property states, your attorney may suggest that jointly-owned assets - especially real estate - be retitled as community property **before** they are put in your trust.

As we explained in Part One, when one spouse dies, community property assets receive a **full** step-up in basis. This reduces the capital gains tax that would be due when the assets are eventually sold. With joint ownership, **only the deceased's share** would receive a step-up in basis - so you would have a bigger gain (profit) when the assets are sold, and would pay more in capital gains tax.

Community property status can be retained when the assets are put in your living trust. So, by retitling jointly owned assets as community property **first**, you will get the full step-up in basis when one spouse dies.

If You Live in a Noncommunity Property State

If you live in a noncommunity property state and have owned an asset jointly with your spouse since before 1976, the asset may be entitled to a full step-up in basis when one spouse dies. If you change the title on it now (even to your living trust), you could lose the full step-up - the deceased spouse's share would still get a step-up, but the surviving spouse's share would not. This could cause your surviving spouse to pay more in capital gains tax if he/she decides to sell the asset after you die.

If the asset is your personal residence, losing the full step-up will not be a problem unless the gain is more than \$500,000. (If you are married, up to \$500,000 of the gain on the sale of your personal residence is now exempt from capital gains tax. See page 167.) But it could be a problem for other assets like farmland, commercial real estate or stocks.

If this sounds like it could apply to your situation, check with your tax advisor **before** you change the title. (For more information, see **Gallenstein v. United States**, a 1992 Sixth Circuit Court of Appeals case. Other circuit courts have followed this ruling in similar cases.)

Your Home, Real Estate, Land, Condominium, Etc.

Depending on the state in which the property is located, a correction deed, grant deed, warranty deed, assignment, or quitclaim deed will be used to change the titles of real estate to your living trust.

The new deed will include how the property is titled now (before you put it into the trust), what the new title should be (to put it into your trust) and the legal description of the property. The deed for each property will be signed by you, witnessed, notarized, and recorded in the county where the property is located.

Again, your attorney will probably put your home in your living trust for you at no extra cost. This is usually a good idea since the home is the most valuable asset most people own, and the legal description and titles must be exact.

Out of State Property

If you own property in another state, you will want to transfer it to your living trust to prevent a conservatorship and/or probate there. Your attorney can contact a title company or an attorney in that state to handle the transfer for you.

You may also be able to do part (or all) of it yourself. First find out what is involved - check with an attorney or escrow office in that state to find out the proper form to use, to verify the process, and to get the name and address of the recording office. In some states, your trust may have to be recorded - if so, a certificate of trust should be all that is needed. However, it may be more convenient (and wise) to have the local attorney or escrow office handle the transfer for you.

Current Mortgage

Putting real estate - especially your home - into your living trust should not disturb your current mortgage in any way. Even if the mortgage contains a "due on sale or transfer" clause, retitling your home in the name of your living trust should not activate the clause. (It would still be a good idea to contact the lender **before** you transfer the property so you don't inadvertently activate the clause, especially if you own rental property or commercial real estate. The lender may charge a small fee to approve the transfer.)

In the past, some people who wanted to put their homes into their living trusts were met with resistance. Many banks, savings and loans, and mortgage companies (called primary lenders) who write home mortgages simply did not understand living trusts. Many were also afraid the **secondary** lenders - institutions who buy home mortgages from these primary lenders, providing them with more money to loan out - would not buy mortgages if the borrower was a living trust instead of an individual.

But things have changed as living trusts have become so popular. Fannie Mae, Freddie Mac and Ginnie Mae (which buys FHA home mortgages) - the major secondary lenders - all now consider a revocable living trust to be an "eligible borrower" as long as normal guidelines are met (for example, the property must be owner-occupied, they want to make sure the trustee is authorized to borrow against the property, and they usually want the owner to be a trustee, which most people are anyway).

These recently published guidelines will make it much easier to transfer your home into your living trust, to refinance your home after it is in your living trust (without having to temporarily remove it from the trust), and even to purchase new real estate in the name of your living trust.

If you do run into resistance, it will probably be from a lender who has not informed its loan officers about living trusts or simply doesn't want to change the way it does business. If this happens to you, you can always take out the mortgage in your personal name and then transfer the property to your living trust after the closing - or you may want to find another lender.

Homeowner's, Liability, and Title Insurance

Your homeowner's and liability insurance should be changed to reflect your living trust on the title and the trustees as additional insureds. (If you are your own trustee, it will show you as trustee instead of you as an individual.) Your agent will be able to make this change for you (probably at no charge). Usually all the insurance company will need is a letter of instruction from you and a copy of the new deed.

Title insurance should also be changed. Check to make sure your title insurance company will still insure title when your living trust is the owner of the property. Most will. In fact, one of the largest title insurance companies routinely issues title insurance when the property is in a living trust. (And they do not require a separate title search.)

Property Taxes

Most owners of real estate pay a property tax every year based on the appraised value of the property. Transferring real estate to a living trust should not cause your property to be reappraised because the underlying ownership is the same (remember, it's **your** trust) and because the trust is revocable (remember, you can take the property out of your trust and put it back into your individual name at any time).

Even so, you may need to notify the tax assessor's office. In California, for example, a "Preliminary Change of Ownership Report" must be filed. This is a simple form (with check boxes) that the attorney usually completes at the same time the new deed is prepared.

Transfer Tax

Generally, a transfer tax is charged whenever property is sold. Putting real estate into a living trust does not constitute a sale, because you can take the property out of the trust at any time. So, in most states, there will be no transfer tax when you transfer property to your living trust.

However, a few states and counties are looking for creative ways to raise revenue and they may charge a transfer tax anyway. For example, Pennsylvania **used** to charge a transfer tax when real estate was transferred into a living trust and **any** beneficiary was someone other than a spouse, grandparent, parent, child, grandchild (and spouse) or sibling (and spouse). So if you named a friend or a charity as a beneficiary of your living trust (even as an Alternate beneficiary), you had to pay a transfer tax on real estate you put into your living trust. This tax was recently repealed, specifically for living trusts.

Exemption From Capital Gains Tax When Residence Sold

Previously, if you were over age 55, you were allowed a one-time \$125,000 exemption of the gain (profit) on the sale of your home. Also, if you sold your home and bought a new one for at least the same price within two years, the profit from the sale of your previous residence was exempt from capital gains tax, providing you had owned and made this house your principal residence for at least three of the previous five years. Putting your home in a living trust had no effect on either of these exemptions.

Thanks to **The Taxpayer Relief Act of 1997**, we have a new capital gains tax exemption that replaces these two previous ones. Now, under current tax law, if you sell your home and you are single, up to \$250,000 of your gain (profit) will be exempt from capital gains tax - providing you have owned and made the house your principal residence for at least two of the past five years. (If you are married, up to \$500,000 will be exempt.) You can use this exemption only once every two years. Having your home in a living trust will have no effect on you getting this new capital gains tax exemption.

Homestead Exemption From Creditors

As we explained in Part Two, part or all of the value of your home may be protected from creditors' claims under your state's homestead laws. Putting your home in a living trust should not cause you to lose this protection.

Rental Real Estate

Under current tax law, the expenses you have from rental real estate (including mortgage interest, property taxes, insurance, repairs, depreciation and other operating expenses) can usually be deducted **only** from rental income.

If you don't have enough rental income (called "passive income") to offset your expenses (called "passive losses") in the year they are incurred, you can carry the excess losses ("net losses") forward and deduct them from rental income in subsequent tax years. If you have not been able to deduct all of your losses by the time you sell the property, you can write them off then.

As usual, there are exceptions:

1. If you earn your living mainly in the real estate business (for example, you are a contractor, builder or broker), you may not be affected by these "passive loss" rules.
2. If your Adjusted Gross Income (as defined on IRS Form 1040) is less than \$150,000 and you actively participate in the management of the property (approve repairs and new tenants, write checks, make management decisions, etc.), you can deduct up to \$25,000 (\$12,500 if married filing separately) in net losses each year from your ordinary income (wages, tips, etc. as defined by the IRS on Form 1040). (If your AGI is more than \$100,000, the \$25,000 is gradually phased out so that, by the time the AGI is \$150,000, the amount of passive net losses that can be deducted from ordinary income is reduced to "0.")

Transferring rental real estate to your living trust does not affect the way you handle these losses while you are living. However, if you are currently allowed to deduct up to \$25,000 in net losses from your ordinary income, these losses may be handled differently **after** you (and your spouse) die. For a full explanation, see Part Eight.

If You Suspect the Property is Contaminated

You can still put contaminated property in your living trust but the trustee can personally be responsible for any clean up. As we explained in Part Two, if you are your own trustee, this won't affect you because you are **already** responsible. But, remember, if the clean up is not complete by the time your successor trustee steps in, he/she (and, ultimately, your beneficiaries) can also be liable. If you suspect that property you own may be contaminated, be sure to read the discussion of this in Part Two. And make sure you tell your attorney **before** you transfer the property to your trust.

Credit Cards, Notes You Owe

Setting up a living trust should not affect any credit cards, loans or notes you owe. These are not assets, so you don't need to do anything with them. You just continue making your required payments as usual.

Mortgages, Loans, And Notes Owed To You

If you have "owner-financed" any assets (for example, you "took back" a note on a house you sold), loaned someone money or have any other notes payable to you, you will need to assign these mortgages/loans to your living trust. This is done by an assignment (as we explained earlier). It is signed by you only (not the other party), notarized and attached to the original document. If the original mortgage was recorded, some attorneys will also record the assignment.

If you have loaned someone money without documenting the loan, this would be a good time to put it in writing to prevent disputes over the terms and nature of the loan. Write up the terms of the loan and have it signed by the other party. An assignment can then be prepared to transfer the loan to the trust.

Checking, Saving, And Pay-on-Death Accounts

You will need to change the ownership of your checking and saving accounts to your living trust. New signature cards will then need to be signed by the trustee(s). If you are your own trustee, you can sign the signature cards with just your usual signature.

You may need to sign new account agreements. Some institutions will require a new account, with a new account number and new checks. If you are your own trustee, the information on your checks does not need to change - they can still be printed with just your name, address, and telephone number on them - and you continue to sign checks the same way you always have.

If you have named beneficiaries on any accounts, you'll want to change them to your living trust. For example, you may have established an account and named your spouse, child or grandchild as the beneficiary. These are called "Totten trusts." The account title probably includes the words "in trust for" (or "ITF"), "as trustee for" (or "ATF"), "payable-on-death" (or "POD"), or "transfer on death" (or "TOD").

Remember, by changing the beneficiary on these to your living trust, you prevent the possibility of the court taking control of the funds if your beneficiary is a minor or incapacitated when you die, or dies before (or at the same time as) you. The institution will probably have its own form to change the beneficiary.

To change the ownership or beneficiary of an account, the institution will probably ask to see a copy of your trust document. Remember, this is for your protection and, as we explained in Part Five, a certificate of trust should satisfy their requirements.

Certificates Of Deposit

These should be retitled in the name of your trust. Some let you name a beneficiary - if yours does, the beneficiary should also be your trust. You do not need to cash these in to do this.

Some institutions will retitle the certificates immediately with no penalties. If yours requires you to wait until the certificate matures, you can go ahead and change the beneficiary and use an assignment to transfer your ownership interest to your trust. Then, when the certificate matures, you can change the title to your trust before you renew it.

Note: This process does not apply to IRAs that are invested in CDs. We discuss IRAs and your living trust later in this section.

What About FDIC Insurance?

The Federal Deposit Insurance Corporation (FDIC) insures deposits at banks and savings associations that are FDIC members for up to \$100,000 per account category per institution. "Deposits" include checking and saving accounts, retirement accounts (including IRAs and Keoghs), NOW accounts, and CDs. Securities, mutual funds and other such investments are not considered "deposits" and therefore are not covered by the FDIC.

When you retitle FDIC-insured accounts in the name of your living trust, the insurance coverage may change. In fact, your living trust accounts may qualify for much more FDIC insurance.

The general formula the FDIC uses when determining insurance for living trust accounts is: (the number of grantors living at the time the FDIC-insured institution fails) times (the number of qualifying beneficiaries living at the time the institution fails) times \$100,000.

So, for example, if you and your spouse have one living trust together (you are Co-Grantors) and have named your three children and five grandchildren as the beneficiaries - and certain conditions, explained below, are met - your trust would be insured for up to \$1,600,000 while everyone is living. (Two Grantors times eight qualifying beneficiaries times \$100,000 = \$1,600,000.) By contrast, if you and your spouse had a joint account instead, it would only be insured for up to \$100,000.

For your living trust to be eligible for this additional coverage, it must meet certain conditions, which include:

The title of the account must indicate that a trust is involved. For example, " John Doe and Mary Doe, Trustees of the Doe Family Trust, dated month/day/year," "Doe Family Trust," and "Doe Family Revocable Trust," would all be acceptable titles.

A qualifying beneficiary can only be a spouse, child or grandchild of the grantor (a parent, sibling, niece,

nephew or non-relative does not qualify) and must be listed by name in the "deposit account records" of the institution (for example, on the signature card).

There can be no conditions in the trust that would prevent a qualifying beneficiary from eventually receiving his/her share of the trust after you (and your spouse) die. For example, it is not okay to say that "my daughter will receive her inheritance only when she removes that ring from her nose" or "my son will receive his inheritance when he graduates from medical school" - because if these events never happen, the beneficiary would not receive his/her share.

Credit Union Accounts

Most credit union accounts can easily be transferred to your living trust. To do this, you will need to set up a new account titled in your trust's name and transfer your existing account(s) to it.

Of course, to have an account at a credit union, you must be a member. And in order for your trust to qualify, all "parties" of your living trust - the grantor(s), trustees, and beneficiaries - must be eligible for membership. Since most living trusts only include family members (who are usually eligible to join anyway), this is not a problem for most people.

If you have named a corporate trustee as a successor trustee (which some people do), this may still be okay - because when a corporate trustee steps in, they will usually close the credit union account anyway and transfer it to an account they manage.

If your living trust does not qualify as a member, there are still some things you can do. You can name your living trust as the "pay on death" beneficiary on the account or add your living trust as a "joint owner with right of survivorship" (joint owners do not have to be members). Then, when you die, your credit union accounts will automatically be owned by your trust.

No special membership card or agreement is usually required when you open the new account for your living trust. The credit union will probably ask to see your trust document to make sure it qualifies for membership, what the trustee's powers are, who the successor trustees are, and when they are authorized to step in. (Although they may need to see who your beneficiaries are, they do not need to know how you will provide for them.)

Your trust, just like any other member, will be entitled to vote at annual meetings. However, since the trust is not a person, someone (usually the trustee) will need to be given the authority to vote for the trust.

These rules apply to federal credit unions (more than half of the 14,000 credit unions are federally regulated), but even those that are state regulated will often follow these guidelines.

Note: If you think you may want to take out a loan at some point, you should probably keep an individual account with the minimum required balance. That's because your trust would only be allowed to borrow an amount equal to its own value.

Safe Deposit Box

You will need to change the box authorization card to your trust and the trustee(s) will need to sign the card. This will allow your successor trustee to have ready access at your death or incapacity. Your bank or savings and loan officer can help you do this.

Stocks/Bonds/Mutual Funds

• *Street Accounts*

If you maintain an account in the name of your bank or brokerage company (called a "street account") or invest in a mutual fund, they will need written instructions from you to change the name on your account to your trust.

Call them first to see if you should send a letter of instruction (remember, your attorney will probably include sample letters with your trust) or if they have their own form they can send you - or if they have their own procedures you will need to follow.

They may request that your signature be guaranteed. Your local banker or broker can probably do this for you (just call ahead and make sure). You will sign the form or your letter in your banker's or broker's presence, and he/she will affix a stamp that "guarantees" your signature.

They may also ask to see a copy of your trust document (again, the certificate of trust should be all they need).

• If You Possess Certificates

If you have possession of actual stock and securities certificates, you can set up an account at a brokerage house or other financial institution. They will transfer the titles to the name of your trust for you and keep the certificates for you. This way you do not have to worry about misplacing them, losing them in a fire, or making frequent trips to your safe deposit box.

If you are more comfortable keeping the actual certificates yourself, you will need to have new certificates issued in the name of your trust. (Never write or mark on an original stock or bond certificate.) Your broker or banker can have them reissued for you (they may charge a small fee).

You can also do this yourself. Your attorney can prepare a "stock power," a short document that assigns the securities to the trust, identifies what is being transferred (for example, 50 shares of General Electric stock), the certificate numbers, and the name(s) of the trustees. You'll sign the stock power and have your signature guaranteed (as above).

You'll then need to locate the stock transfer agent . This is the organization that is authorized to transfer title on stocks and bonds. For bonds, the transfer agent is usually the institution from which you receive payments on the bond. If you have stock certificates, don't rely on the name of the transfer agent on the certificate - it may be outdated. Call a brokerage house and ask them. Your attorney may also be able to find out the transfer agent for you.

Send the transfer agent - by certified mail - a letter, instructing them to issue new certificates in the name of your trust; a certificate of trust; and the certificates. Send the stock power separately, also by certified mail. (Do not send the stock power and the certificates together in the same envelope - if someone intercepts them, they would be able to negotiate them.) Make sure you keep copies. And check the new certificates as soon as you receive them.

If you have lost a certificate, contact the transfer agent and request an "Affidavit of Lost Certificate and Indemnity Agreement." Complete and sign the affidavit, and follow the instructions to furnish bond.

Savings Bonds

Series E, EE, H and HH bonds can be transferred to your living trust with no adverse tax consequences. You will continue to receive current income from Series H and HH bonds. Accrued interest on Series E and EE bonds can continue to be deferred until the bond matures.

To have savings bonds re-issued in the name of your living trust, you'll need form PD-1851. If you have named a beneficiary on a savings bond, you can also change it to your trust using form PD-4000. (If you are changing a beneficiary on a Series E bond, the current beneficiary will need to sign the form; if this person is deceased, you will need to send along a death certificate.)

You can call the Federal Reserve Bank yourself to order forms or if you have questions (since forms change, make sure you verify which one(s) you need and the procedure). If you live in the mid-west or western U.S., you can call their customer service number in Kansas City: 1-800-333-2919. If you live in the eastern part of the country, call the customer service number in Pittsburgh: 1-800-245-2804. (By the way, the representative we

spoke with was very knowledgeable and helpful - and said they get a lot of calls from people who want to re-issue their savings bonds in the names of their living trusts.)

Automobiles/Boats/Other Vehicles

Most states will permit a vehicle title to be re-issued in the name of your trust. However, unless your car is valuable and substantially increases the size of your estate, you probably will not want it in your trust. That's because, if you are at fault in an auto accident and the injured party sees that your car is owned by a trust, they may think "deep pockets" and be more likely to sue you. Also, if you are using a corporate trustee, they may not want to manage your car unless, of course, it is of considerable value.

Remember, every state allows a nominal amount of assets to transfer without probate. If the value of the vehicle is within this amount, your attorney may just suggest that you leave your vehicle out of your trust.

Some states now allow you to name a beneficiary for your vehicle. If yours does, you can name your trust as the beneficiary. However, in some states, this will require the payment of an excise (transfer) tax, just as if the trust had purchased the vehicle.

Take Florida, for example. Currently, Florida has a \$100 "new wheels tax" (in addition to other registration fees). This fee does not apply if you trade in your existing car for a new one. But it does apply if you buy an additional car or if you have never owned a car before. So, because your trust has not owned a car before, you will have to pay the "new wheels tax" when you transfer it into your trust. But you will only have to pay it once; you won't have to pay it again if you replace that car with another one. However, a car is considered "exempt" property in Florida. So, if you plan to leave your car to your spouse or an heir, you don't need to transfer it to your trust and spend the \$100; your spouse or heir can transfer the car title after you die for less than \$100. But if you plan to leave your car to someone else, then it is probably worth putting it into the trust and paying the \$100 fee. (Don't you just love finding out what's going on in Florida?!)

You may want to call your state's license bureau to find out the process where you live. Of course, your attorney will know the procedures and laws in your state and will be able to advise you. Depending on the costs involved and the value of the vehicle, you may want to wait until you purchase your next one.

If you do title a vehicle in the name of your trust, notify your insurance company so they can change your policy to reflect the change of ownership and list the trustee as an additional insured. (If you are your own trustee, it will show you as trustee instead of you as an individual.) They may request a copy of the new registration and a letter of instruction from you. They will probably make the change for you at no charge.

Personal Untitled Property

Your attorney will probably prepare an assignment to transfer your personal property (furniture, artwork, clothing, jewelry, cameras, sporting equipment, books, etc.) to your trust. If these articles are of substantial value, you would want them in your trust.

However, if the value of these articles is low enough that a probate would not be required in your state (as we explained above), your attorney may recommend leaving these out of your trust. They could also be intentionally left out if there was a desire to cut off creditor's claims in probate (as we explained in Part Two).

Life Insurance

In many cases, you will want your living trust to be both the beneficiary and the owner of your insurance policies.

Naming your trust as the beneficiary gives you maximum control over the proceeds. It keeps the courts from getting involved if your loved ones are incapacitated, die before you (or at the same time as you), or are minor

children. You can keep the proceeds in trust until you want your loved ones to receive the money. You can be sure the money is used to pay your final expenses. And by naming your trust instead of your spouse as the beneficiary, you can even keep control of the funds if your spouse should remarry.

Note: If you live in a community property state and the insurance was purchased with community property funds, your spouse is entitled to half of the proceeds and may need to sign a consent form if you want to name your living trust as beneficiary.

Naming your trust as the owner of your policies gives you maximum control over the policies and more flexibility. For example, if you name your spouse or someone else as the owner, you might worry that they will cancel the policy or change the beneficiary.

If you have a policy that has a cash value and you name your trust as the owner, your successor trustee would be able to borrow on the policy at your incapacity to help pay for your care. And if you suffer from a terminal illness, your successor could apply for a "Living Benefit" currently offered by many insurance companies. (Under this program, the "death benefit" is paid to you before you die - instead of to your beneficiary after you die - so the cash is available to help meet expenses while you are living.)

However, if your estate is large enough that it would have to pay estate taxes, you should probably consider having a Life Insurance trust (or other arrangement, like a Family Limited Partnership) to save estate taxes. We explain how they work in Part Nine.

Employer-Provided Insurance

These would include life insurance (including split dollar insurance), accident insurance and disability insurance your employer provides for you. Your living trust should be the beneficiary when you have the option. Your employee benefits or personnel department will have the appropriate forms and can help you complete them.

Sole Proprietorship

Business licenses and DBAs (doing business as) should be changed to show your living trust as the owner. An assignment is used to transfer business property to your trust.

Closely-Held Corporation

First check to make sure that transferring your interests to a living trust will not trigger an event covered by a buy-sell agreement. (If it does, you can request that the document be changed.) The appropriate corporate records will then need to be prepared to transfer title. Share certificates will also need to be re-registered in the name of your trust. To do this, a Stock Power (prepared by your attorney) and the certificates will need to be sent to the attorney or officer who handles the transfers.

Subchapter S Corporation

With a subchapter S corporation, both the earnings and any losses of the corporation are passed through to the owners personally. Earnings are taxed only once at the personal level and any losses can be deducted from ordinary income. (With a "C" corporation, earnings are taxed twice - once at the corporate level, and again at the personal level when the earnings are distributed. And, until the corporation is sold or liquidated, losses can only be deducted from corporate earnings.)

Transferring subchapter S corporation stock to your living trust does not cause any change or any problem while you are living. After you die, however, the stock can only stay in your living trust for up to two years - after that, it would lose its "S" status and become a "C" corporation.

But this rarely happens - because two years is usually plenty of time to distribute the stock to the beneficiaries so the "S" status can be retained. If you don't want your beneficiaries to receive the stock outright, the IRS also

allows it to be transferred to other trusts that meet its qualifications to retain the "S" status. The IRS creatively calls one of these "qualified subchapter S trusts" (QSST).

Your attorney should plan for the distribution of subchapter S stock when he/she prepares your living trust document.

Limited Partnerships/Corporations/Limited Liability Companies

If you are involved in any real estate (or other) partnerships, corporations or limited liability companies, your interest should be assigned to your trust. This probably will not disturb the existing agreement or affect your partners in any way, but you should check the agreement or corporate by-laws just to be sure.

The general partner may already have a form to assign your interest to your trust. If not, your attorney can prepare one. The assignment should identify your interest that is being transferred, how the interest should be titled, and that the trustee accepts any liabilities as well as benefits.

Send the assignment to the general partner with a letter instructing him/her to make the transfer. Since other documents may need to be prepared to complete the transfer, you may want to give the general partner a limited power of attorney to sign the other documents for you. (The general partner may charge a fee to do this.)

General Partnership Interests

This transfer is handled in the same way as a limited partnership. However, your signature will probably need to be notarized, and the assignment should include a provision for the other partners to consent to it. The partnership agreement may also require you to send the assignment to the other partners or general partner to sign - as verification of their acceptance - and return the assignment to you.

If you are using a corporate trustee with your trust, they may not be able to serve as a general partner. A special trustee may have to be appointed instead.

Copyrights, Patents, And Royalties

"Intellectual properties" such as these can usually be transferred to your living trust with an assignment drafted by your attorney. (Make sure your attorney is familiar with these.)

Oil And Gas Interests

Transferring proven oil and gas interests - mineral leases, overriding royalty interests, production payments, and working and operating interests - can all be transferred to your living trust without losing the percentage cost depletion deduction (similar to depreciation). Your trust and/or beneficiaries can continue to claim the deduction after you die.

The process to put these interests into your trust will vary, depending on the state in which the property is located. You may want to have your attorney do these transfers for you. They can be tedious - the legal descriptions and depletion allowances must be exact, and you want to be sure everything is done properly.

Club Memberships

As long as the membership agreement does not prohibit it, a club membership can be assigned to your trust. Some membership agreements allow you to name a beneficiary - if yours does, it should be your living trust.

Foreign Assets

Foreign assets can be transferred to a living trust if revocable living trusts are recognized in that country. You or your attorney will need to contact an attorney in the country where the assets are located to find out if there are any specific advantages - or disadvantages - to putting these assets in your trust and the process that should be followed.

ASSETS REQUIRING SPECIAL CONSIDERATION

While you should start with the general premise that all titles and beneficiary designations should be changed to your living trust, there are a few assets that you may not want in, or cannot be placed into, your living trust. Here are some you may own.

IRA, 401(k), 403(b), Pension, Profit Sharing, Keogh And Other Tax-Deferred Plans

These are plans that were created to encourage you to save for your retirement. They are called tax-deferred plans because you did not pay income taxes on this money when the contributions were made. The income taxes are deferred until you withdraw the money at a later time--ideally, at your retirement when your income (and tax bracket) is lower.

You can't leave your money in these accounts forever. At a certain point (your required beginning date), Uncle Sam says you must start taking money out. Generally, this is April 1 following the year in which you become age 70 1/2. However, if you have money in a company plan (pension, profit sharing, etc.), you continue working beyond age 70 1/2 and you own less than 5% of the company, you can delay your required beginning date on those accounts until your actual retirement date. (This exception does not apply to IRAs.)

Determining the amount you are required to take out each year (your required minimum distribution) is much easier now than it used to be. Each year you divide the year-end value of your account by a life expectancy divisor found on a chart (the Uniform Lifetime Table) provided by the IRS. The result is your required minimum distribution for that year. For example, the divisor for age 72 is 25.6. If your year-end account balance is \$100,000, you divide \$100,000 by 25.6. The amount you are required to withdraw for that year is \$3,906.25.

You can withdraw more than the required minimum distribution amount at any time. But if you don't need all your money, or if you die before you use it all, you'd probably like to let it continue to grow tax-deferred for as long as you can, with as much as possible going to your spouse and/or children, and as little as possible going to taxes.

In the past, this has been very difficult to do because the rules governing these distributions were cumbersome, complex and confusing. But in 2001 and 2002, the IRS changed many of the rules, finalized the regulations (which had been "temporary" for several years) and actually made it easier to get the results you want.

You still cannot change the ownership of your tax-deferred plans to your living trust. You can, however, name your living trust as the beneficiary. But before you do, be sure to consider all of your options. As you will see in the next few pages, whom you name as beneficiary will have a significant impact on how long the tax-deferred growth can continue, and how much of your tax-deferred savings will go to Uncle Sam in income and estate taxes.

Who Should Be Your Beneficiary - If You Are Married

Option 1: Spouse as Beneficiary

Most married people, especially those who have been married for some time, name their spouse as beneficiary. And, in most cases, this will be your best option. The two main reasons are 1) the money will be available to provide for your surviving spouse, and 2) it gives you the spousal rollover option.

Also, if your spouse is more than ten years younger than you are, you can use a different life expectancy chart that will make your required distributions less. (This lets the tax-deferred growth continue longer on more money.)

Here's how the spousal rollover option works. If you die first, your surviving spouse can "roll over" your tax-deferred account into his/her own IRA, further delaying income taxes until your spouse must start taking required minimum distributions at his/her required beginning date. When your spouse does the rollover, he/she names a new beneficiary--preferably a much younger one, as your children and grandchildren would be.

After your spouse dies, the beneficiary's actual life expectancy will be used for the remaining required minimum distributions. Depending on the beneficiary's age at that time, that could mean decades of tax-deferred growth.

For example, let's say your grandson is 20 when he inherits a \$100,000 IRA from your spouse. Assuming a 7% annual return, and that he takes out only the required minimum distribution each year, over the next 63 years (the life expectancy of a 20-year-old), this \$100,000 IRA will provide your grandson with over \$1.7 million in income!

What if you name your spouse as beneficiary and your spouse dies before you? Under the old rules, this was often a problem. Unless you remarried, you lost the spousal rollover option. You could name a new beneficiary, but the distributions after your death were still based on your and your deceased spouse's life expectancies. But now, under the new rules, if your spouse dies first, you can name a new beneficiary--and after you die, the distributions will be based on the new beneficiary's life expectancy.

There are some possible disadvantages of naming your spouse as beneficiary that you need to consider. Keep in mind that, after you die, your spouse will have full control of this money, which may not be what you want. You may have children from a previous marriage or feel that your spouse may be too easily influenced by others after you're gone. (Your spouse doesn't have to do a rollover, you know. A total lump-sum distribution could be very tempting--even if all the income taxes would have to be paid at once!)

Naming your spouse as beneficiary could also cause you to pay too much in estate taxes. Remember, in Part Three, we explained how you can waste your estate tax exemption if you leave everything to your spouse. If your estate is large enough to pay estate taxes and most of your estate is made up of your tax-deferred savings, naming your spouse as the beneficiary could cause you to waste some or all of your exemption. (If you have other assets that can be applied to your exemption, this would not be a problem.)

If your spouse becomes incapacitated, the court could take control of this money. The money could also be lost to your spouse's creditors.

If any of these "disadvantages" fit your situation or concern you, keep reading

Option 2: Children, Other Individuals as Beneficiary

If your spouse will have plenty of assets--or if you have reason to believe your spouse will die before you--you could name your children, grandchildren or other individuals as beneficiary.

The tax benefits can be great. Since you are not leaving this money to your spouse, your estate tax exemption can be applied to it--that saves estate taxes. And if your beneficiary is much younger than you (as your children and grandchildren would be), you can get maximum "stretch out" on the tax-deferred growth.

However, as we explained in Part Two, any time you name an individual as a beneficiary, you lose control. After you die, your beneficiary can do whatever he/she wants with this money, including cashing out the entire account and destroying your carefully made plans for long-term, tax-deferred growth.

There is the risk of court interference at incapacity. Also, money that has been withdrawn would be available to the beneficiary's creditors, spouse and ex-spouse(s). And if you leave a substantial amount to a grandchild, it could be subject to the generation skipping transfer tax, which is equal to the highest estate tax rate in effect at that time and is in addition to estate and income taxes. (See Part Nine for a full explanation.)

For maximum control (especially with a minor or irresponsible individual), consider naming your living trust as beneficiary instead, as explained below.

Option 3: Living Trust as Beneficiary

Naming your living trust as beneficiary will give you maximum control over your tax-deferred money after you die. That's because the distributions will be paid not to an individual, but into your trust which contains your written instructions stating who will receive this money and when.

With an A-B living trust as beneficiary, you can provide for your surviving spouse for as long as he or she lives, yet keep control over who receives the money after your spouse dies. Plus the proceeds can be used to satisfy your estate tax exemption and save estate taxes. (See Part Three for an explanation of estate taxes and an A-B living trust.) Your trust could also provide periodic income to your children or grandchildren, keeping the rest safe from irresponsible spending and/or creditors.

While you are living, the required minimum distributions will be paid to you over your life expectancy (determined from the Uniform Lifetime Table). After you die, the required distributions can be paid to the trust over the life expectancy of the oldest beneficiary of the trust.

Just as you can do now, the trustee of your trust will be able to withdraw more money from the account if needed to follow the instructions in your trust, but the rest can stay in the account and continue to grow tax-deferred. You can, of course, name anyone you wish as trustee. But if the trust will exist for a long period of time (for example, to provide for your grandchildren), you may want to consider a corporate trustee. (See Part Four for more on corporate trustees.)

There are some possible disadvantages to consider with a trust, as well. For example, you will not be able to provide for your spouse and stretch out the tax-deferred growth beyond your spouse's actual life expectancy. Remember, after you die the distributions will be paid over the life expectancy of the oldest beneficiary of the trust. If your spouse is a beneficiary of your trust, he or she will probably be the oldest beneficiary. If your spouse is not a beneficiary of the trust, the oldest beneficiary may be one of your children. That would let you extend the tax deferral over your child's life expectancy. But then the money would not be available to your spouse.

Also, many trusts pay income taxes at a higher rate than most individuals, but only on income that stays in the trust. (With a revocable living trust, this would apply only after you die.) Distributions from your tax-deferred account that are paid to the trust are subject to income tax, and if they were to stay in the trust, the higher tax rates would apply. But usually this is not the case because the trustee distributes the income to the beneficiaries of the trust, who then pay the income tax at their own (usually lower) rates. (See Part Eight for more information on trusts and income taxes.)

In order for a trust to work this way as beneficiary of a tax-deferred account, it must meet certain requirements:

- 1) It must be valid under state law.
- 2) It must be irrevocable or become irrevocable at your death (which a living trust does).
- 3) The beneficiaries must be individuals and identifiable from the trust document.
- 4) A copy of the trust document and any subsequent revisions must be provided to the Plan Administrator or IRA trustee, custodian or issuer.

Depending on the kind of trust you would like to use, there may be additional regulations governing them. Check with your attorney.

Option 4: Charity/Foundation as Beneficiary

If you are planning to leave an asset to charity anyway after you die, a tax-deferred account can be an excellent asset to use. That's because when you name a charity as the beneficiary, there will be no income or estate taxes on this money after you die.

If you name a charitable remainder trust (explained in Part Nine) as beneficiary, your spouse, children or others can receive an income for a set number of years or for as long as they live--and you will still save income and estate taxes. You can also set up your own charitable foundation and have the foundation pay your kids a salary to run it. (See Part Nine.)

The only downside of naming a charity as beneficiary is that it has no life expectancy. Under the old rules, if you named a charity as beneficiary, you had to use just your life expectancy when determining distributions during your lifetime. This made the distributions larger than they would have been with another beneficiary. But now, even with a charity as your beneficiary, you use the Uniform Lifetime Table to determine your required minimum distributions, so this is not the problem it used to be.

However, you still need to be aware of a charity's "zero" life expectancy, as you will see next.

Option 5: Some or All of the Above as Beneficiary

You don't have to choose just one of these options. You can split a large IRA into several smaller ones and name a different beneficiary for each one. If your money is in a company plan, you can roll it into an IRA and then split it.

You could name several beneficiaries for one IRA, but then you must use the life expectancy of the oldest beneficiary for the entire IRA, just as when you use a trust as beneficiary. This is especially important if a charity is involved. Remember, it has a life expectancy of zero, so the IRS would consider it the oldest beneficiary. Depending on when you die, this could cause the entire IRA to be paid out in just five years.

With separate IRAs--one for each beneficiary--you can use each one's life expectancy. This will give you the maximum stretch out over all their ages. It will also be more fair to your beneficiaries, especially if there is a wide difference in their ages, or if you want to include a charity.

When should you divide a larger IRA? That will depend on your planning decisions. Doing it now, while you are living, is the cleanest approach. If you die first, your surviving spouse can also split your IRA when he/she does a rollover and names new beneficiaries. And now, under the new rules and under certain circumstances, your IRA can be divided into separate accounts in the year after you die.

Setting up separate IRAs now will make it a little more complicated for you when calculating your required minimum distributions each year, because one will have to be calculated for each IRA. But you can take the total of your distributions from any IRA you wish. And it can be well worth the trouble. Splitting your IRA like this can also help you save estate taxes.

Note: Any time you name someone other than your spouse as the beneficiary, you need expert advice. You'll need to find an attorney who is experienced in this area, especially if you have large amounts in these plans. Also, your spouse may need to sign a consent form. Even in noncommunity property states, spouses now have rights to retirement plan and other benefits.

Who Should Be Your Beneficiary - If You Are Not Married

If you are not married, your decision will be less complicated. You can name any individual, a trust, or a charity as the beneficiary.

If you want an individual to receive this money after you die, consider using a trust to keep more control.

Before you make a decision, consider all of your options carefully. And make sure your attorney has experience in this area, especially if you have a sizeable amount in your tax-deferred plans.

If You Die Without A Beneficiary

What happens under the new rules if you die without a beneficiary? That depends upon when you die. If you die before your required beginning date, your account must be paid out within five years. If you die after your required beginning date, distributions will be paid over the remaining years of your "fixed life expectancy." This is determined from an IRS table based on your age in the year you die.

How to Change the Beneficiary Designation for Your Tax-Deferred Plans

Under the new rules, you can change your beneficiary at any time while you are living and the distributions after you die will be paid over that beneficiary's life expectancy.

In fact, now your final beneficiaries do not have to be determined until September 30 of the year after you die, which allows for some neat "clean-up" planning to be done after you're gone. For example, your spouse could "disclaim" some benefits so a grandchild could inherit. Of course, no new beneficiaries can be added after you die. So you must have the right beneficiaries named on your account before then.

To change the beneficiary of employer-sponsored plans (such as a 401(k), pension, or profit sharing plan), contact your employee benefits or personnel department for the proper form. To change the beneficiary of your IRA or Keogh, you will need to contact the institution where your account is located.

Some plans have restrictions on what you can do on the beneficiary designations. Be sure to read the document carefully. If the plan will not let you do what you want to do, consider rolling your money into an IRA as soon as you can. If your money is already in an IRA and the institution will not agree to what you want, consider moving your IRA to another institution.

Roth IRA

If you qualify, you may want to consider converting some or all of your tax-deferred money to a new Roth IRA. You can only convert from a traditional IRA, so if your money is in a different tax-deferred plan, like a pension or profit sharing plan, you must first roll your money into a traditional IRA and then convert it to a Roth IRA. You will have to pay ordinary income taxes on the amount when you convert.

Why go to all this trouble? Because it can be well worth it. For example:

- 1) Unlike a traditional IRA that requires you to start taking your money out at age 70 1/2, with a Roth IRA there are no required minimum distributions during your lifetime. So you can leave your money there for as long as you wish.
- 2) Unlike a traditional IRA, you can continue to make contributions to a Roth IRA after you have reached age 70 1/2.
- 3) As a general rule, after five years or age 59 1/2 (whichever is later), all distributions to you and your beneficiaries will be tax-free.

- 4) You can stretch out a Roth IRA just like a traditional IRA. After you die, distributions can be paid over the actual life expectancy of your beneficiary. Your spouse can even do a spousal rollover and name a new beneficiary.

Your tax advisor can help you determine if converting to a Roth IRA would be a good move for you.

Tax-Deferred Annuities

Tax-deferred annuities sold by insurance companies are not IRAs or qualified plans. As a result, they are not governed by the same IRS rules as the plans listed above and the preceding discussion does not apply to them.

Before you name a beneficiary, read your contract carefully. There may be some restrictions or income tax issues you need to be aware of when making this decision.

For example, if you are married, naming your spouse as beneficiary may allow the tax-deferred payments to continue over your spouse's lifetime after you die—while naming someone other than your spouse (like your living trust) could cause the balance to be paid out all at once after you die. (One solution may be to name your spouse as first beneficiary and your living trust as second beneficiary.)

Incentive Stock Options

Stock options are often used as a form of compensation for valued employees, who are given the right to buy company stock at some point in the future at a predetermined (and usually very favorable) price.

Usually, you have to wait until a certain amount of time has passed before you can "exercise" the option (buy the stock). You do not pay income taxes until the stock is later "disposed of" which, according to the IRS, is a "sale, exchange, gift or transfer of legal title."

The laws are not clear about whether putting stock options into your living trust would cause you to violate the "waiting time" or if this would be considered a "transfer of legal title," which then would cause you to pay income taxes at that time.

However, we are aware of at least one company that has written to the IRS, asking for an opinion on whether transferring incentive stock options to a revocable living trust would be considered a "disposition." The response from the IRS (called a "Private Letter Ruling") states that it would not be.

You or your attorney will probably want to read the plan document to see if there are any restrictions on transferring these options to your living trust. You may also want to write the plan administrator for approval. Depending on how long you have before an option expires, you may want to just wait until after you exercise the option and then transfer the stock to your living trust.

Section 1244 Stock

Business owners know that many new businesses fail, so they often incorporate under Section 1244 of the Internal Revenue Code. If the business is later sold or liquidated at a loss, this allows the stockholders (the owners) to take the loss on the stock as an ordinary loss instead of a capital loss.

Normally, when you sell stock (and other investments) and have a loss, it is considered a capital loss and can only be used to offset capital gains (your profits when investments are sold). If your capital losses exceed your capital gains for that year, under current tax law you are only allowed to deduct \$3,000 (\$1,500 if married filing separately) of the excess loss per year from your ordinary income (wages, tips, etc. as defined by the IRS on Form 1040).

But with 1244 stock, the stockholders can deduct the loss from ordinary income instead of from just capital gains. Individuals can currently deduct up to \$50,000 in these losses per year; married couples filing jointly can deduct up to \$100,000 in losses per year. Any excess loss can be rolled forward to subsequent tax years.

Under current tax law, transferring Section 1244 stock to a living trust would cause you to lose this tax benefit. Whether or not you will want to put this stock in your living trust will probably depend on how long you have been in business and how profitable the business is.

If you think the business may have to be sold or liquidated at a loss, you probably do not want to put Section 1244 stock in your living trust. However, if the corporation is successful and there is little chance of a loss, you may want to go ahead and do so. We suggest you discuss this with your attorney and accountant before you decide.

Professional Corporations

State laws require shareholders of professional corporations (like doctors and dentists) to be licensed members of their professions. Since a living trust is revocable and you keep control of the assets you put in it, some attorneys feel that transferring a professional corporation to a living trust would not be a problem. But because the laws do not specifically mention living trusts, many attorneys suggest that you leave these out of your trust for now, at least until the laws are changed to include living trusts.