CHAPTER 1

Introduction

In modern estate planning, the use of living trusts has become the routine rather than the exception. Although numerous types of living trusts are designed to accomplish a variety of purposes, every living trust directs that actions be taken with respect to the trust property before and after the death of the settlor of the trust. If a trust does not own the property with respect to which the actions are to be taken, the purposes of the trust are totally or partially frustrated. Given the common employment of living trusts, and the valuable purposes they accomplish for estate planning clients and their beneficiaries, it is essential that these trusts contain the assets they are designed to hold. Funding is the process of transferring ownership of assets from a settlor to a trust.

Consider the following questions and answers from a nationally syndicated real estate column:

Q: My mother died last December. As her only child, several times I asked if she had a living trust. She said she did, even giving me the name of her lawyer. It’s true that she had a living trust. But I discovered last month that she never transferred title to her home, a small rental property, her bank accounts and common stocks into her living trust.

When I contacted the lawyer who charged her $1,000 to create the living trust, he claimed it wasn’t part of his job to make sure she “funded” her living trust by changing titles. As a result, I will have to incur unnecessary attorney and probate fees to transfer all these assets into my name as my mother’s sole heir.

I hope you will warn your readers that not only should they have a living trust to save their heirs time and money, but they must transfer their assets into the living trust if it is to accomplish its purpose.

A: Thank you for sharing that difficult situation so we can learn from it. You are absolutely correct that a living trust can only serve its purpose of avoiding probate costs and delays if the trustor’s major assets have been transferred into the living trust. . . .
Frankly, the attorney who charged your mother $1,000 to prepare her living trust should have at least included the transfers of her real estate into the living trust. Paying a modest extra fee for such title transfers would have been worthwhile.

Unfortunately, many trustors like your mother “forget” to follow through by transferring the titles of their real estate and other assets such as bank accounts, stocks and bonds into their living trusts. In other words, your mother’s living trust was worthless because it contained no assets when she died.

Q: My late husband and I owned a farm together. We intended to put its title into our living trust, as you often recommend. After the living trust was drawn up by our lawyer, I recall signing some sort of a deed. I thought it was to transfer title to our farm into our living trust. Somehow, my late husband never signed that deed (which was recorded).

Now, I recently learned my late husband’s half of the farm property must go through the local probate court because it was not deeded into our living trust. The attorney who prepared our living trust is dead. To make matters even worse, we own two properties in Florida that apparently were never deeded into our living trust, so they must go through probate in Florida, necessitating hiring another lawyer in Florida.

Is there anything I can do to avoid all these legal costs and delays?

A: Your situation shows what can go wrong with living trusts when prepared by inept lawyers. If you and your late husband were co-owners of your property, but he never signed the quitclaim deed to your joint living trust, his share never became part of the living trust.

As for the Florida properties that were never transferred into your living trust, the bad result is that you must hire a Florida lawyer to probate these properties. You could have avoided all these costly problems if title to your properties had been correctly deeded into the living trust. For more details, please consult your attorney.

The scenarios described in the above excerpts, not at all uncommon situations, raise numerous questions. In the case of the mother who died with an unfunded living trust, did the attorney who drafted the trust advise her of the need to transfer the assets into the trust? Did the mother negotiate a lower attorney’s fee for preparing the trust by assuming responsibility for funding it herself? Concerning the surviving spouse whose out-of-state properties were not funded into a joint trust before her husband’s death, why would a probate in the foreign jurisdiction be required if the properties were jointly owned? If the late husband were the sole owner of the Florida properties, did the couple inform their attorney about the existence of the properties? Did their attorney inquire about the full extent of their real estate holdings when the trust was prepared? How was the lack of signature on the recorded deed to their farm property overlooked?
If the drafting and execution of the trust is considered the essential legal product, and the funding of the trust is regarded as an afterthought, problems such as those described in the foregoing excerpts will result. To provide the most effective service to the trust client, the completed living trust package should encompass the planning, drafting, execution, and funding of the trust. Moreover, the funding of the trust should be taken into consideration from the commencement of the planning process. The trust may contain particular assets that require special provisions to be inserted into the trust at the drafting stage. Funding documents that transfer title of assets to the trust can be executed immediately after the trust agreement. Finally, the client’s estate planning matter should not be considered complete until the transfers to the trust of all the intended trust assets have been made and confirmed.

A. SCOPE OF THE BOOK

This book is designed as a handbook for attorneys and their staff members to use in supervising and accomplishing the funding of their clients’ living trusts. After a brief discussion of the types and purposes of living trusts, the book addresses important threshold issues, such as the importance of funding, the roles of the attorney and the client in trust funding, and the necessity for retitling assets in the name of the trust. The book then examines several basic general funding considerations and provides an overview of the funding process. Because different assets raise different transfer issues, the funding of specific assets is then addressed in detail.

It should be emphasized that there is little standardization when it comes to funding living trusts. Several factors contribute to the lack of uniformity of practices among attorneys in this area. The most obvious point is that the transfer of virtually all assets to a living trust is governed by the state law of conveyancing for each particular type of property. The different state laws account for some of the variation in funding practices. Another element relates to the rules and practices of companies that control the retitling of various assets. For example, the requirements for transferring a bank account, brokerage account, share of stock, or life insurance policy depend on the institution, brokerage firm, transfer agent, or company involved. In many cases, a company’s particular transfer form or application must be used in order for the transfer to be effective, and these forms vary widely. The experience and personal makeup of the individual attorney is also an important factor in how the attorney approaches funding decisions. Consider the question of seeking permission from a condominium association before transferring a condominium to a living trust. A new attorney or an attorney with a cautious bent may recommend that a client secure consent of the association in advance of the transfer of title. An attorney with twenty years’ experience in this area may advise the condo owner that, as a practical matter, seeking the permission of the association is likely to be more trouble than it is worth. Moreover, if the condominium association finds out about the transfer and questions it, the matter can usually be satisfied by furnishing the association with the name of the person entitled to vote for the unit and any other information required. The procedures described herein are designed to indicate one or more ways that assets are funded into living trusts and to point out issues to consider before funding particular assets into a trust.
B. LIVING TRUSTS

1. Trust Basics

Under the time-honored definition, an express trust is a relationship in which the trustee holds an interest in property subject to an equitable obligation to hold or use the property for the benefit of the beneficiary. The key elements of a trust are: an intention to create a trust; a settlor; a trustee; the trust property; and a beneficiary. A trust can be created during a settlor’s lifetime or at the time of his or her death. If created during life, a trust is called a living or inter vivos trust, and the creator is referred to as the settlor, grantor, or trustor. A living trust is created by the execution of a trust agreement setting forth the terms of the trust. A trust created by will is called a testamentary trust, the creator is called the testator, and the terms of the trust are set forth in the will.

2. Revocable Living Trusts

In a trust-centered estate plan, the estate planning client’s basic package includes a revocable living trust, a pour-over will, and a durable power of attorney. The revocable living trust is the core of the client’s estate plan. The trust contains provisions for use of the income and principal during the settlor’s lifetime and directions for disposition of the trust property upon the settlor’s death. All or most of the client’s assets are funded into the revocable living trust upon its creation. The revocable living trust is accompanied by a pour-over will. The will directs that any probate assets owned by the client at death are given to the acting trustee of the revocable trust. A durable power of attorney authorizes an attorney-in-fact to act on behalf of the client during his or her lifetime. The power of the attorney-in-fact survives the client’s disability but terminates upon the client’s death. The estate planning documents dealing with the client’s property are typically supplemented by a health care directive and a living will, under which the client appoints individuals who can make health care decisions on his or her behalf under various circumstances.

The terms of a revocable living trust depend on the client’s individual circumstances. If the client is an unmarried individual, the client is typically the settlor, trustee, and current beneficiary. In the capacity of trustee, the client is authorized to use the income and principal of the trust for his or her own benefit. The trust agreement nominates successor trustees to serve upon the client’s incapacity or death and directs the disposition of the property remaining in the trust upon the client’s death. The property can be distributed outright to the designated beneficiaries or held in further trust for their benefit. A husband and wife who do not require estate tax planning typically create a joint revocable living trust into which they transfer their individually and jointly owned assets. The husband and wife are the settlors, co-trustees, and beneficiaries during their joint lifetimes and the lifetime of the survivor. If one spouse becomes incapacitated or dies, the other spouse continues serving as the sole trustee. As in the case of an unmarried individual, the settlors of a joint trust nominate successor trustees and provide for the disposition of the trust property upon the death of the survivor. If a married couple requires estate tax planning, the customary
approach is for the couple to divide their property between two revocable living trusts. The husband is the settlor of one trust, and the husband and wife are the co-trustees and beneficiaries of the trust during the husband’s lifetime. The wife is the settlor of the other trust, and the wife and husband are the co-trustees and beneficiaries of the trust during the wife’s lifetime. Upon the death of the first spouse to die, the property in the trust can be split between a credit shelter trust to maximize use of the deceased spouse’s applicable exclusion amount and a marital gift in trust or outright. In all cases, the settlor or co-settlors of the trust retain the right to amend or revoke the trust.

Revocable living trusts serve two important functions in an estate plan, one of which applies during the settlor’s lifetime and the other of which transpires at death. A living trust eases the burdens on the settlor and his or her family in the event of the settlor’s incapacity. If a person becomes incapacitated, that is, unable to transact business on his or her behalf, and no precautions have been taken in advance of the incapacity, then it is likely that a guardianship will have to be established under which a guardian is appointed by a court to manage the person’s affairs. The rules for establishing and maintaining a guardianship of property depend on the applicable state law, but they have traditionally been regarded as rigid and costly to the guardianship estate. Moreover, the legal procedure required to determine incompetency inevitably exacts a personal cost on family members. Although a durable power of attorney can be useful upon incapacity of the principal, a living trust is the best method for handling potential incapacity. The settlor can serve as the trustee and beneficiary of the living trust during his or her lifetime for so long as the settlor remains competent. If incapacity occurs, the successor trustee named in the trust agreement assumes the management of the trust property for the benefit of the settlor-beneficiary without necessity for a formal guardianship.

The other main purpose of a living trust is to avoid probate of the assets owned by the trust upon the death of the settlor. Probate is the process by which assets owned by a decedent at death are formally transferred to the beneficiaries under the will. Typically, the personal representative appointed under the will identifies and collects the decedent’s assets, pays the decedent’s debts, expenses of administration, and taxes, and distributes the remaining assets to the intended beneficiaries. The probate process is generally supervised at each stage by a probate court and has traditionally been considered to be cumbersome and costly. In contrast, when the settlor of a living trust dies, the successor trustee is already familiar with the trust assets because they are identified on the trust property schedule. The successor trustee pays the decedent’s debts, expenses of administration, and taxes, and distributes the remaining trust assets to the beneficiaries. Although a trust administration parallels a probate, the trust administration is generally regarded as less costly and time consuming than a probate.

Other advantages of a revocable living trust over a will may be important in particular contexts. For example, a revocable living trust affords privacy to a settlor and family because of the absence of court supervision of a trust administration. In contrast, the personal representative of an estate is required to offer the will for probate and file an inventory identifying the probate assets and their values. The probated will and the inventory become public records. In addition, use of a revocable living trust is
often recommended when it is anticipated that a client’s dispositive scheme will be contested. Whereas a will does not operate until the testator dies, a revocable living trust takes effect immediately upon execution and funding and the trustee may serve for years until the settlor dies. Because the trust is already in existence at the settlor’s death, there is a sense that the validity of the trust is more difficult to challenge than the validity of a will. Moreover, a state statute of limitations may limit the time period within which the validity of a trust can be challenged.6

The creation of a revocable living trust does not in and of itself achieve tax savings for federal income, gift, or estate tax purposes. Because the settlor of a revocable living trust retains the right to revoke the trust, the trust is considered a grantor trust for federal income tax purposes.7 The income and other tax items of a grantor trust are included in the grantor’s gross income as if the trust did not exist.8 Transfers of property to a revocable living trust do not constitute taxable gifts for federal gift tax purposes.9 When the settlor of a revocable living trust dies, the value of the property in the trust is included in his or her gross estate.10 If estate tax planning is required, however, revocable living trusts, like wills, can incorporate measures to reduce estate taxes, such as credit shelter trusts and gifts to charity.

3. Irrevocable Living Trusts

A general rule of thumb in estate planning is that a trust should be revocable unless there is a specific reason to make it irrevocable.11 The revocability feature preserves flexibility by giving a settlor the opportunity to amend or revoke a trust in light of changed conditions. The main purpose of irrevocable trusts in estate planning is to achieve federal income, gift, or estate tax savings. Each type of irrevocable trust is structured and funded to achieve the specific tax savings that the settlor needs or desires. The following examples illustrate some common types of irrevocable inter vivos trusts.

**EXAMPLE: Irrevocable Life Insurance Trust**

H and W own assets with a combined value of $6 million. In addition, H owns an insurance policy that will pay $1 million at his death. If H owns the policy at his death, the entire $1 million will be included in his gross estate for federal estate tax purposes.12 One strategy for H is to create an irrevocable life insurance trust and transfer the insurance policy to the trustee. The transfer of the policy constitutes a completed gift to the trust equal to the fair market value of the policy on the date of the transfer. The trust can be structured so that the gift will qualify for the annual gift tax exclusion; if there are not enough beneficiaries to cover the entire gift, then H will use up part of his gift tax applicable exclusion amount. H’s future transfers to the trust to enable the trustee to pay premiums may also qualify for the annual gift tax exclusion. If H survives the three-year period following the date of the transfer, the life insurance proceeds will not be included in H’s gross estate.13 An insurance policy is a particularly ideal subject for lifetime giving because the value of the
policy for gift tax purposes is substantially less than the full amount of the proceeds that would otherwise be included in H’s gross estate. By creating a trust to hold the policy and the insurance proceeds, H can make the proceeds available to meet any liquidity needs of his estate and can control the disposition of the proceeds in further trusts for the benefit of W and his descendants as H deems advisable.

**EXAMPLE: Charitable Remainder Trust**

B, age sixty-three, recently retired from a career as a business executive. B receives a pension and other income from various investments. B is divorced and her adult children are married and self-supporting. B is involved with several philanthropic causes to which she plans to bequeath a considerable portion of her estate. Although B makes regular cash gifts to several charitable organizations, she does not feel comfortable making a substantial outright gift at this time. B created an irrevocable lifetime charitable remainder annuity trust under which she reserved the right to receive an annual annuity equal to 8 percent of the initial net fair market value of the assets transferred to the trust, for the duration of her life. Upon her death, the remaining trust property will be distributed to three named charitable organizations. In addition to the considerable pleasure B takes in announcing the charitable gifts while she is living, B also receives tax advantages. She funded the trust with highly appreciated shares of stock. If she sold the stock, she would have to pay a capital gains tax. By giving the stock to the charitable remainder annuity trust, B is eligible for an income tax charitable deduction equal to the value of the remainder interest in the trust.14 The trustee can sell the stock without paying capital gains tax15 and use the proceeds to invest in income-producing assets that will generate the annual annuity payments. When B dies, the value of the trust property will be included in her gross estate because of her retained interest, but an estate tax charitable deduction will be available for the full amount passing to the charities.16

**EXAMPLE: Trust for Minor Beneficiary**

P and Q are the proud grandparents of several grandchildren ranging in age from two months to fourteen years. The couple’s estate planning attorney has advised them of the strategy of making annual gifts to the grandchildren subject to the annual gift tax exclusion. One option to accomplish the gifts is to create an identical trust for each minor beneficiary. Under the terms of each trust, the trustee has discretion to use both the income and the principal for the benefit of the beneficiary. Each trust will terminate when the trust beneficiary reaches age twenty-one, unless the beneficiary elects to extend the term of the trust. If the beneficiary dies before attaining age twenty-one, all principal and income of the trust will be distributed to the beneficiary’s es-
tate. Gifts to the trusts from P and Q will not be considered gifts of future interests and therefore will qualify for the annual gift tax exclusion.17

EXAMPLE: Qualified Personal Residence Trust

G, a sixty-five-year-old widower, has three children and several grandchildren. G has a considerable net worth and is concerned with minimizing his federal estate tax. G makes annual gifts to his children and grandchildren that are covered by the annual gift tax exclusion; G has not made any gifts to use up his unified credit. G owns a vacation home that he inherited from his parents and intends to leave to his children, who anticipate maintaining the family ownership for future generations. As an estate tax savings strategy, G creates an irrevocable trust that will terminate upon the earlier of his death or the end of a ten-year term. G transferred the vacation home to the trust. During the term of the trust, G is trustee of the trust and has the right to use the home. When the trust terminates, the home will pass to his children in equal shares. At that point, G will have no interest in or right to occupy the home. To use the home, G will have to pay rent to the children or visit as their guest. G made a completed gift of the remainder interest in the vacation home to his children when he transferred the property to the trust. The value of the gift is equal to the fair market value of the home at the time of the gift, reduced by the value of G’s retained interest.18 The value of the retained interest depends on the value of the property, the interest rate under Internal Revenue Service tables, the settlor’s age, and the term of the trust. If the value of the gift is less than G’s applicable gift tax exclusion amount, G will not have to pay any federal gift tax upon the transfer. If G survives the ten-year term, the home will not be part of his gross estate for estate tax purposes. Thus, by making a gift equal to a fraction of the home’s fair market value, G will remove the entire value of the home, plus any postgift appreciation, from his gross estate.

As discussed in Chapter 5, which addresses the funding of trusts with specific assets, numerous state and some federal laws limit the kinds of property that can be transferred to a trust as well as specify the required means for accomplishing a transfer. Because irrevocable inter vivos trusts are created primarily as tax planning vehicles, provisions of the Internal Revenue Code and accompanying Treasury Regulations often dictate some of the required terms of these trusts. The tax laws may also limit the types of property that can be funded into a particular irrevocable living trust without jeopardizing its intended purpose. For example, certain mortgaged property should not be transferred to a charitable remainder trust because the transaction violates the self-dealing rules applicable to charitable remainder trusts.19 Similarly, the favorable treatment for qualified personal residence trusts is not available unless the property transferred to the trust is used or held for use as a personal residence of the holder of the term interest in the trust.20 Thus, before funding property...
into a particular irrevocable trust, the attorney should be familiar with all the terms and limitations required to achieve the desired tax results.

C. THE INTEGRAL ROLE OF FUNDING

The critical role of trust funding cannot be overemphasized. In estate planning, every trust is created to accomplish one or more specific objectives. Moreover, every trust is designed to hold property that will be transferred to the trust either during the settlor’s lifetime or at the time of death. The purposes of a trust cannot be accomplished unless the property that it was intended to hold is actually owned by the trust. Thus the funding of a trust is essential to achieving the settlor’s objectives in creating the trust.

For example, the two main purposes of a revocable living trust are to provide for the possible incapacity of the settlor and to avoid probate at death. In order to accomplish both purposes effectively, all or most of the settlor’s property must be transferred or funded into the trust before the event of incapacity or death. If a settlor becomes incapacitated, only the assets owned by the trust are available for management by the successor trustee. Assets still owned by the settlor individually are not subject to the successor trustee’s authority and may require the creation of the guardianship that the trust was intended to avoid. A durable power of attorney may alleviate some, but likely not all, of the problems attendant upon a client’s incapacity. Similarly, assets owned individually by a settlor at death are subject to probate—the very process that the trust was intended to avoid. Although a pour-over will accompanies a living trust, a probate is required to pass the unfunded assets under the pour-over will into the trust following the settlor’s death.

Funding is equally essential in the context of irrevocable living trusts. While the purposes of irrevocable trusts are various, the necessity of properly funding the trust remains constant. The purpose of an irrevocable life insurance trust, for example, is to remove the value of insurance proceeds from the insured’s gross estate and thereby reduce estate taxes. The sole asset of the irrevocable life insurance trust is a life insurance policy that will either be transferred to the trust or newly purchased in the trust name. The trustee must hold the policy, pay the annual premiums using additional gifts made by the settlor, and receive and distribute the insurance proceeds upon the settlor’s death. If the intended trust asset is an existing life insurance policy, the policy must be transferred to the trust and the trust must be designated as the beneficiary of the proceeds. If the appropriate steps are not taken to transfer ownership of the policy and change the beneficiary designation, then, notwithstanding the excellent planning and the executed trust document, the proceeds will be included in the settlor’s gross estate at death. A trust for minors is typically created to make annual or periodic gifts in trust for the benefit of minor children and grandchildren using the annual gift tax exclusion. The advantage is that the donor’s estate is depleted without incurring a gift or estate tax. To make a gift, a donor must relinquish dominion and control over the property to be given. Thus, unless the settlor of a minor’s trust actually transfers money or other property to the trustee of the trust, a gift does not occur and the intended estate tax savings are not achieved. The sole asset of a qualified personal residence trust is residential property. The settlor’s gift of a residence to the trust is the
key to a completed gift, on which depends the planned estate tax savings. To effectuate the gift, the settlor executes a deed to himself or herself as trustee of the qualified personal residence trust.

D. COORDINATION BETWEEN ESTATE PLANNING DOCUMENTS AND FUNDING

When drafting trust and accompanying estate planning documents, the fact that one or more assets need to be transferred into the trust, presently and possibly in the future, needs to be taken into account. The two documents that require specific attention are the trust agreement and the durable power of attorney.

1. Trust Agreement

The estate planning attorney should be aware of the specific assets to be transferred to a living trust at its inception. If additions to the trust are authorized, the attorney should also anticipate that similar or different assets may be transferred to the trust in the future. In drafting a trust, therefore, an attorney should make sure that the trustee has the authority to hold and manage the assets that will or may be transferred to the trust.

A settlor chooses a trustee or successor trustee because of the settlor’s confidence that the trustee is competent and trustworthy to manage the trust assets. As a consequence, the typical trust document incorporates a broad range of trustee powers intended to provide the trustee with basically the same ability to hold and manage the trust assets that the settlor himself or herself would possess. Particularly where a trust is designed to operate for many years into the future, the goal is to provide the trustee with the maximum degree of flexibility to manage the trust assets in the best interests of the beneficiaries and to handle anticipated or unforeseen circumstances. The powers of a trust are variously expressed. Some trusts incorporate the powers of trustees enumerated in a state statute, while other trusts specifically list all the powers the settlor wishes to grant to the trustee.

The typical list of trustee powers is broad enough to accommodate most common trust assets. For example, real estate is a common trust asset, and most trustee powers cover the trustee’s ability to sell, exchange, improve, lease, and mortgage real property. Certain assets, however, may require special attention. For example, a settlor may wish to fund a sole proprietorship or other closely held business into the trust. Because small businesses may not be considered suitable trustee investments under the rules governing fiduciary investments, the trust should expressly authorize the trustee to retain any assets transferred to the trust. The settlor may even express his or her desire that the trustee retain the business so long as the retention does not cause significant detriment to the trust and its beneficiaries.

2. Durable Power of Attorney

A client uses a durable power of attorney to empower an agent to act on his or her behalf. Unless revoked by the principal, a durable power of attorney survives the principal’s incompetency but terminates upon the principal’s death. A durable power of
attorney can be general, in that it authorizes a broad range of actions to be taken by the attorney-in-fact, or specific, in that it is tailored to a specific transaction or function. Some states permit a “springing” durable power of attorney that does not take effect until the incapacity of the principal. Most states have statutes setting forth the requirements for a durable power of attorney, including language necessary for the power to survive the principal’s disability and formalities for execution.

If a settlor creates a trust but for some reason fails to fund property into the trust, the settlor can transfer the property into the trust when the omission is discovered. If, however, the settlor has become incapacitated, the question may arise whether an attorney-in-fact can transfer the settlor’s property to the trust using a durable power of attorney. Unless a power of attorney expressly authorizes the attorney-in-fact to transfer the principal’s property to the principal’s revocable living trust, it may not be clear whether the attorney-in-fact has the authority to complete the trust funding.

To make certain the settlor’s intent, a durable power of attorney for a client with a living trust should include express language authorizing the transfer of assets to a living trust. There are many variations for the attorney to consider. Some attorneys provide authority for the attorney-in-fact to transfer assets to a revocable trust but not to an irrevocable trust. Some attorneys recommend use of a special durable power of attorney that deals solely with funding issues and specifically identifies the revocable living trust to which the assets may be transferred. This approach has the advantage of specificity and therefore the power may be more acceptable to third parties. Other attorneys include the funding language as one of many powers granted to the agent under a general durable power of attorney. The following is sample language of such an express provision:

I authorize my attorney-in-fact to transfer, assign, and convey any property or interest in property that I own to any trust of which I am a beneficiary and under the terms of which I expressly have the power, exercisable alone or with others, to amend or revoke such trust, whether such trust was created before or after the execution of this power of attorney.

The attorney may also wish to consider authorizing the attorney-in-fact agent to designate the trust as beneficiary of death benefits under retirement plans and life insurance policies.

The primary limitation to using durable powers of attorney in general is the reluctance of third parties to recognize the authority of the attorney-in-fact. Institutions and firms routinely reject powers of attorney on various grounds, such as of lack of specificity, staleness, and concern that the power may have been revoked.

EXAMPLE: Durable Power of Attorney Rejected

M, an elderly widow, created a revocable living trust into which she transferred all her assets with the exception of her automobile. In M’s state, a relatively simple procedure allows postdeath transfer of title to a decedent’s
automobile by affidavit, so many settlors choose not to transfer their automobiles to their revocable trusts. M named her daughter, D, as successor trustee and as attorney-in-fact under a durable power of attorney. M thereafter suffered a stroke, and it became clear that she would no longer be able to drive. After arranging for a sale of M’s vehicle, D went to the local Department of Motor Vehicles (DMV) to transfer title to the purchaser using the power of attorney from M. The DMV rejected the durable power of attorney, explaining that the department had its own form for power of attorney and only recognized that form. Fortunately, M soon recovered sufficient mental capacity to execute the title certificate herself. If M’s condition has deteriorated, however, it is unclear whether the DMV could have been convinced to accept the power of attorney and, if so, how much time and effort on the part of D and M’s attorney would have been devoted to pursuing the matter.

Another risk associated with relying on a power of attorney is that the original power of attorney may be misplaced, lost, or unavailable to the attorney-in-fact. For example, in states that do not allow springing powers, a durable power of attorney becomes effective upon execution. The principal may be unwilling to deliver the power of attorney to the attorney-in-fact at that time. If the principal places the original power of attorney in a safe-deposit box along with his or her other estate planning documents, the attorney-in-fact may not be allowed access to the box to retrieve the document.

Thus, using a durable power of attorney to fund a trust should not be considered as an alternative to funding a trust when the trust is created. Rather, a durable power of attorney should be viewed as a possible avenue for funding assets that were omitted from a trust initially or assets acquired after the trust was created in the event of the settlor’s incapacity.

E. ROLES OF ATTORNEY AND CLIENT

The estate planning attorney and the trust client collaborate in the process of funding a living trust, with each party performing a vital role. The necessity for funding the trust, and the respective responsibilities of the attorney and client in the funding process, should be confirmed to the client in writing. As with all estate planning matters, the preparation and funding of a revocable living trust should be done in a timely fashion. If a client should become incapacitated or die before an estate plan is fully implemented, the attorney does not want the failure of the plan to be the result of his or her undue delay in pursuing the client’s file. The potential adverse consequences of delay should also provide an incentive for the client’s cooperation.

1. The Attorney’s Role in Trust Funding

Practices vary considerably regarding the attorney’s involvement in the funding process. At one extreme is the practitioner who prepares a trust and related documents for a client and, without preparing any of the funding documents, simply advises the client of the need to transfer all his or her assets into the trust. At the other end of
the spectrum is the attorney who views the trust client’s matter as a package involving
the initial planning advice, the preparation of the documents, and the preparation
of the funding documents and oversight of the funding process. A common practice
between the two extremes is to prepare the trust and related documents and also pre-
pare a limited number of funding documents, such as the deeds for realty and a deed
of gift for the untitled personal property.

There seem to be two recurring rationales expressed by practitioners who do not
provide substantial funding assistance to trust clients. The first is that the funding of
trusts is a simple matter that the client can handle without an attorney’s assistance.
The second is that preparing the funding documents and overseeing the funding pro-
cess are too time consuming to accomplish considering the fee that can be charged to
a trust client. Whereas experience in retitling hundreds of assets suggests that the first
rationale is questionable, the concern about the attorney’s reasonable compensation
for the time spent overseeing the funding of a trust is legitimate when numerous as-
sets are involved. Both considerations are discussed below.

Numerous factors affect a client’s ability to carry out the funding process. First of
all, some funding documents require a legal expertise that laypersons do not possess.
Typical funding documents include deeds of real property, deeds of gift for personal
property, and assignments of various property interests. Thus, certain assets are un-
likely to get transferred to the trust unless the attorney prepares the applicable trans-
fer documents. In addition, the retitling of numerous assets requires knowledge of
legal issues with which a layperson is unfamiliar. Examples include restrictions on the
funding of mortgaged realty, Section 1244 stock, and stock in professional corpora-
tions. Without an attorney’s advice on these and similar issues, the client may un-
knowingly make an inadvisable or unauthorized transfer of property to a trust that
may entail significant adverse financial or tax consequences.

Even in more routine funding matters, there are obstacles facing a client attempt-
ing to fund a trust. Clients vary considerably in their understanding of the trust
arrangement, sophistication in business affairs, commitment to the process, and abil-
ity to persevere in frustrating circumstances. Even a competent and motivated client
will encounter pitfalls that are likely to result in unfunded or incorrectly funded assets.
For example, many funding issues require contact with an institution or company to
request a procedure or form to effectuate a transfer. The first representative contacted
may be unfamiliar with trusts and provide incorrect advice. The client may accept this
information without challenging it or requesting to speak with a supervisor. Another
potential area for mistakes concerns the proper signature format and verification re-
quired for various transfers. For example, a form to open a new brokerage account in
the name of a trust may require a Medallion signature guarantee. A client may be unfa-
miliar with signature guarantees and submit the form without the guarantee. This will
result in delay in funding the account into the trust. Moreover, many clients do not re-
able the importance of confirming requested changes. For example, the data from
most forms and letters of instruction are entered into a computer by a company repre-
sentative. The changed information appears on the next statement, report, or other
communication from the company. Errors routinely occur in this data entry, with the
result that the trust is not properly identified as the owner of the asset.

In contrast to a client, who may be involved in the funding of only a single trust
during his or her lifetime, the estate planning attorney has familiarity with all the intricacies of the funding process. The attorney can prepare the legal documents required, advise the client concerning any legal issues, guard against the wide array of potential errors and pitfalls, deal effectively with uncooperative or unknowledgeable company representatives, and confirm the asset transfers. By assigning the client specific tasks that only he or she can perform in the process rather than placing the entire responsibility on the client, the attorney is more likely to get the client’s attention and cooperation and the funding is more likely to be completed in a timely manner.

The time required to fund a trust depends on the type of trust. The settlor of an irrevocable life insurance trust may need to transfer one or more policies to the trustee of the trust. In this context, it is clear that the limited amount of time involved in preparing the change of ownership and beneficiary forms and confirming that the changes were correctly made would dictate that the attorney handle the funding rather than risk potential errors that may occur if the client handles the transfer with the insurance agent or, even worse, does not ever effectuate the transfer. In contrast, the funding of the typical revocable inter vivos trust, which may involve numerous and varied assets, can unquestionably be a time-consuming matter.

Many estate planning attorneys charge a flat fee for a trust matter, and the base flat fee should incorporate a reasonable amount for funding. Attorneys who routinely represent trust clients may find that funding matters within the base flat fee range tend to “average out.” For example, one client may be an elderly widower with a home, a checking account, and a brokerage account. Another client may own a residence, a vacation home, a vacant lot, several bank and brokerage accounts, an individual retirement account, and a pension plan. Based solely on the number of assets, more time would normally be devoted to funding the second client’s trust than to funding the first client’s trust. This discrepancy will even out if both clients pay the base flat fee.

An attorney using a flat fee for trust matters should charge a suitable amount over and above the base flat fee if the funding promises to be complex. Before recommending a trust and quoting a fee to an estate planning client, the attorney should become familiar with the nature and extent of the client’s assets. Certain “red flag” assets alert an attorney to a potential complex funding process. Examples are stock in a corporation that the client holds in his or her own name and is unwilling to place in a brokerage account, partnership interests, and interests in closely held corporations. In addition, when a client owns a large number of assets, the attorney can assume that some of them will require extra attention in funding. In these cases, the attorney can anticipate at the outset that the funding will take additional time and quote a premium as part of the flat fee.

The estate planning attorney can somewhat reduce the time and expense associated with funding by developing and maintaining a funding forms file. The new attorney can begin by using the suggested forms in this book, adapted to incorporate the applicable state law requirements and the attorney’s personal preferences and style. The forms should include all the common transfer documents, such as deeds and assignments, as well as accompanying cover letters. Each time the attorney encounters a new funding issue and develops a new form or letter, that document should be converted to a form and added to the funding forms file. Similarly, each time the attorney improves a form while working on a particular client’s trust, the improvements
should be immediately added to the form so that future clients can benefit from the improvement. By diligently compiling a funding forms file, an attorney can save time and expense, and reduce errors, in preparing the documents required to fund a trust.

Another factor to consider is that the estate planning attorney does not need to be personally involved with all the details of the funding process. Rather, the legal service to the client in connection with funding a living trust is accomplished by a collaboration between the attorney and his or her legal assistant, secretary, or other staff member. The assistance of staff members is invaluable in drafting funding documents, contacting companies, completing forms, and coordinating with clients. By devoting time to training and supervising a staff member, an attorney can minimize the time he or she devotes to routine funding matters and thereby reduce the overall cost of providing this service.

Finally, the attorney may have to recognize that funding trusts will not be the most lucrative aspect of his or her practice. But this practical reality is not uncommon in estate planning. For example, the fee that an attorney can reasonably charge for preparing a will is typically less than (and may be well below) a fee based solely on the attorney's general hourly rate. Attorneys routinely accept this initial "shortfall" by anticipating a future generous fee for probating the deceased client's estate. Similarly, an attorney may decide to absorb some of the initial cost of funding a client's trust in anticipation of a future trust administration that can be quite profitable using either a flat fee or an hourly rate.

In summary, because of his or her training and expertise, the attorney is in a better position than the client to undertake and oversee the funding process. By taking the funding into account when setting a fee, by utilizing staff members to perform routine matters, and by acknowledging the inherent limitations in charging fees in this area, the attorney can maximize the productivity and profitability of funding services. Finally, considering the critical fact that a trust may be completely or partially useless to a client if the trust is not properly funded, the argument that estate planning attorneys should normally take the lead role in trust funding, assisted by the client at the appropriate stages, is compelling.

Note: There are numerous references in this book to steps that the estate planning attorney should take or issues that the attorney should consider. The reference to the attorney is intended to recommend that responsibility for the item mentioned be placed on the attorney rather than the client. In many cases, such items may be handled by the attorney's staff members under the attorney's supervision. Because there are so many variations in how an attorney and his or her staff will divide up the funding process, this book simply designates the attorney as the responsible party and leaves it to the individuals involved to decide when a particular duty will be performed by a staff member.

2. The Client’s Responsibility

The client must be aware from the outset that the funding process is a joint effort in which both the attorney and the client play essential roles. No matter how diligent or thorough the estate planning attorney may be, there are steps in the funding process that the attorney cannot take on the client's behalf.
An attorney typically has either no or limited knowledge about the client’s assets. The client must provide accurate and complete information about his or her assets in order for the funding process to begin. While the attorney may prompt a client’s memory by suggesting typical categories of assets, it is ultimately up to the client to disclose the information. It is not uncommon for clients to recollect the existence of additional assets as the funding process unfolds. Examples of initial information that a client needs to provide include copies of recorded deeds and mortgages and statements for bank accounts, brokerage accounts, mutual funds, individual retirement accounts, and pension plans. Also required are copies of life insurance policies and annuity contracts. If a client owns an interest in a partnership, the client must provide a copy of the partnership agreement and any amendments so that the attorney can determine if a transfer is prohibited or requires consent of the other partners. If consent is required, the client must provide the attorney with the names of the other partners so that a consent form can be prepared. The client must deliver to the attorney any original bonds or stock certificates that are to be retitled in the name of the trust.

The client must execute numerous funding documents, some of which can be signed at the attorney’s office and some of which must be signed elsewhere. For example, to retitle a checking or money market account with a bank, or open a new account in the trust’s name, new signature cards must be signed. This is typically done by the client, who goes to the bank with a letter of instruction and signs new signature cards prepared by a bank representative. Similarly, if a Medallion signature guarantee is required on a change of ownership or other funding document, the client must go to a person authorized to make the required guarantee.

The client generally should be responsible for obtaining the required signatures of third parties. For example, if a checking account jointly owned by a client with a child is to be retitled in the name of a trust, the client should obtain the child’s signature on the letter of instruction to the bank. In the partnership example referred to above, the attorney prepares a consent form, but the client is responsible for obtaining the signatures of his or her partners.

Trust account applications with brokerage firms generally include questions about features of the account that must be answered by the client rather than the attorney. Examples of such questions include whether the trust account will permit margin trading, whether the trustee desires Internet access to the account, and whether the trustee will need checks and debit or credit cards. The attorney should request the client to answer such questions rather than guessing what the client is likely to prefer. Any financial profiles required on brokerage applications should also be prepared by the client.

3. Communication between Attorney and Client

Communication between the estate planning attorney and the client is essential to the successful funding of a trust. If the attorney does not adequately explain the purposes of a proposed trust and the necessity for funding the trust, the client may be reluctant to devote the time and effort required to assemble accurate and complete asset information. Also, because the funding process will typically take at least a few months, it is important for the attorney and client to keep in touch during the pro-
cess. The worst impression a client can have is that the funding process is languishing in the attorney’s office. One effective way to communicate with the client is to furnish him or her with copies of all letters prepared by the attorney during the funding process. The attorney should also conduct periodic progress reviews to ensure that the process is moving forward, that no additional information is required from the client, and that the client has taken any required steps.

NOTES


2. See Bogert and Bogert, The Law of Trusts and Trustees § 1 (rev. 2d ed. 1984); Restatement (Third) of Trusts § 2 (2003).

3. An express trust, which is intentionally created by the owner of property, is distinguished from a resulting trust or a constructive trust. A resulting trust is a trust that arises by operation of law in order to effectuate the presumed intention of the parties. A constructive trust is imposed in equity in order to prevent the unjust enrichment of a party possessing ownership of property that rightfully belongs to another. Ritchie, Alford, & Effland, Decedents’ Estates and Trusts 435–36 (7th ed. 1988).

4. Various procedures are available to reduce the time and expense involved in a typical probate proceeding. For examples, an expedited probate for relatively small estates may be available. E.g., Tex. Prob. Code Ann. §137 (collection of small estates by affidavit); §143 (summary proceedings for small estates). Some states have an unsupervised probate that a person making a will may choose that will minimize the court’s involvement in the process. E.g., Cal. Prob. Code § 10500(a) (independent administration); D.C. Code Ann. § 20-406 (unsupervised personal representative); Mont. Code Ann. §§ 72-3-201, 72-3-225 (informal probate); Tex. Prob. Code Ann. § 145 (independent administration).

5. The estate planner should take care not to overemphasize the cost savings to be achieved by using a revocable living trust rather than a will. Some clients have the mistaken impression that, because a revocable trust avoids probate, there is little to do and few costs to pay when a settlor dies. In practice, while a trust avoids the expense and delay associated with the probate court’s involvement in supervising an estate administration, in other respects a trust administration parallels the administration of an estate. Both a personal representative and a successor trustee must locate and value the assets, pay the debts and administration expenses, file any applicable tax returns, and distribute the remainder as provided in the will or trust. In Florida, the base statutory attorney’s fee for a trust administration is 75 percent of the base statutory fee for a probate. Fla. Stat. Ann. § 737.2041(2). While the fee for representing a trustee is less than the fee for handling a probate, the fee for the trust administration is certainly not negligible.

6. E.g., Kan. Stat. Ann. § 58a-604 (a proceeding to contest the validity of a revocable trust must be commenced within the earlier of one year after the settlor’s death or four months after the trustee has sent the contestant a copy of the trust instrument and a copy of a notice containing specified information).

7. Under Internal Revenue Code (I.R.C.) § 676(a), a grantor is treated as the owner of any portion of a trust over which the grantor has the power to revest title to such portion in himself or herself.


9. A gift of property is complete when the donor has parted with dominion and control over the property and does not have the power to change its disposition, whether for the benefit of the
donor or another. Treas. Reg. § 25.2511-2(b). If the donor of property reserves the power to revest title to the property in himself or herself, the gift is incomplete. Treas. Reg. § 25.2511-2(c).


11. In some states, a settlor may revoke or amend a living trust unless the terms of the trust expressly provide that the trust is irrevocable. E.g., Kan. Stat. Ann. § 58a-602; Nev. Rev. Stat. § 163.560. Conversely, in other states, an inter vivos trust is irrevocable unless the trust expressly provides that it is revocable. E.g., N.Y. Estates, Powers, & Trusts Law § 7-1.16. Whatever the applicable rule, a trust instrument should always expressly state whether the trust is revocable or irrevocable.


13. Id. §§ 2035(a), 2042.


15. Id. § 664(c).

16. Id. §§ 2036(a), 2055(a)(2).

17. Id. § 2503(c). See generally George M. Turner, IRREVOCABLE TRUSTS chap. 8 (3d ed. 2002).


21. The use of a durable power of attorney is discussed in Part D.2 of this chapter.


25. The Florida power of attorney statute expressly provides that an attorney-in-fact cannot transfer assets to an existing trust created by the principal unless expressly authorized by the power of attorney. Fla. Stat. Ann. § 709.08(7)(b)(5).


28. Concerning the funding of a revocable living trust, one experienced commentator observed, “Clearly, counsel will be required to spend significant amounts of time discussing the matters on a practical level with banking institutions, title companies, brokerage firms, and other entities which may become involved in the transfer of assets owned by the clients to the Revocable Living Trust.” Turner, REVOCABLE TRUSTS § 33.17 (4th ed. 2002).

29. The author once worked with an attorney who had the uncanny knack for attracting solely clients with large numbers of complex assets. While a great deal was learned assisting these clients with the funding of their trusts, the acquisition of this knowledge was not without financial cost. Obviously, the “averaging out” strategy discussed in the text would not apply to him and others like him.