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Revocable Living Trusts

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A. Traditional Estate Planning vs. Revocable Trust Planning

1. The Ongoing Evolution in Estate Planning

There has been an evolution in how assets pass at death. At one time, the Will was the central estate planning document, but with the advent of various forms of non-probate transfers, it has declined in importance. Indeed, through the use of joint tenancy and beneficiary designations, it may be possible to completely bypass probate and in such a case, the Will may have no purpose. The revocable trust been part of this evolution toward non-probate transfers, particularly in states with difficult probate systems. This has brought on another set of difficulties, however. Where the Will once was the central point through which testamentary transfers had to pass, now testamentary transfers may be directed by a variety of non-probate means. Trying to coordinate all these different forms of testamentary transfers should be an increasingly important function of revocable trusts.

This outline is written by a Montana attorney and makes several references to Montana law. Montana has adopted the Uniform Probate Code and the Uniform Trust Code, so practitioners in states that have adopted those Acts should find similar if not exactly the same provisions in their own state statutes. References to the Montana Code Annotated (2013) herein are abbreviated M.C.A. References to the Internal Revenue Code of 1986 are abbreviated I.R.C. and references to Treasury Regulations interpreting the Internal Revenue Code of 1986 are abbreviated Treas. Reg.

2. Meaning of "Revocable Living Trust"

When the term "revocable living trust" or "revocable trust" is used in this outline, it refers to a trust created by a trustor (sometimes referred to, interchangeably, as a settlor or grantor) acting as the trustee for the trustor's own benefit for life, the trust can be amended or revoked by the trustor while the trustor is alive, and upon the trustor's death, the trust assets are distributed or retained in trust much as they would be under a Will. It

is quite possible to have a revocable trust that does not meet this description, but that is what is meant here. The terms "living trust" and "revocable inter vivos trust" are interchangeable with what is referred to here as a revocable trust.

During Life

The more precise legal term for a living trust is an inter vivos trust, meaning a trust "during life." This more accurately describes the nature of the trust as one that operates during the life of the trustor; the term "living trust" makes it sound like the trust is living. On the other hand, the abbreviation for an inter vivos trust as an I.V. Trust makes it sound like it is on life support. In any event, these are distinguished from testamentary trusts, which are created through a Will at the time of a testator's death.

Revocable

Under Montana law, a trust is revocable by the trustor <u>unless</u> the trust instrument expressly makes it irrevocable. §72-38-602, M.C.A. But this statute only applies to trusts created on or after October 1, 1989. At least at one time, the majority rule was that a written trust was <u>irrevocable</u> unless the power to amend or revoke was expressly stated or at least implied by the trust instrument.¹ Avoid this issue: make certain that the power to amend and revoke is expressly stated in the trust agreement.

3. Tax Features of Revocable Trusts

It is important to have a basic understanding of the tax attributes of revocable trusts.

- <u>Income Tax</u>: For income tax purposes, a living trust will be treated as grantor trust and the trustor will be treated as the owner of the trust if it is revocable by the trustor or by a nonadverse party. I.R.C. §676(a). As a result, the income of the trust will be taxable to the trustor.
- <u>Gift Tax</u>: For gift tax purposes, the transfer of property to a trust that is revocable by the trustor or by a nonadverse party will not be a completed gift. Treas. Reg. §25.2511-2(e). Consequently, no gift tax return would have to be filed,

¹ See Price, Price on Contemporary Estate Planning, Little Brown & Co. (1992), §10.8, pp. 871-72.

no part of the trustor's unified credit would be used up by such a transfer, and nothing would have been removed from the trustor's estate for estate tax purposes.

• <u>Estate Tax</u>: For purposes of the estate tax, the corpus of a revocable trust is includible in the trustor's estate.

Revocable trusts generally are <u>not</u> used for lifetime tax planning, because transferring assets to such a trust will not be a completed gift removing the assets from the donor's estate. Revocable trusts serve much the same function as a Will as a means of directing the passage of assets at one's death. For lifetime tax planning, an irrevocable trust is more likely to be used. Also remember that revocable trusts are generally revocable only during the trustor's lifetime; upon death they generally become irrevocable, so referring to them as revocable trusts can sometimes become confusing. For that reason, when drafting the trust consider giving it a name that does not include the word 'revocable."

4. The Revocable Trust as a Will Substitute Similarities

In many ways a revocable trust is a Will substitute. It can be used to dispose of a decedent's property in much the same way a Will can, and can implement all the estate tax planning strategies that a Will can (such as credit shelter trusts, marital trusts, and so forth). In contrast to Wills, revocable trusts usually have provisions that apply while the trustor is still alive; they are "inter vivos."

Lifetime Use of Revocable Trust

Typically, a revocable trust will provide for distribution of income and principal to the trustor (and, if married, to the trustor's spouse) while alive, and should also include a provision allowing the trustor to direct the trustee to make distributions in accordance with directions from the trustor. This is an important advantage over Wills. A Will, of course, has no effect until the testator is deceased. A revocable trust can be funded and implemented immediately upon execution. The trustor (who is almost always also the trustee) will then start to administer assets through the trust.

Not every client will want to transfer their assets into a trust. They may not like

the idea of having to open bank accounts for the trust and transfer assets as trustee; it can seems unnecessarily complicated or even confusing. For them, the trust can be executed but left unfunded; the trust is established and ready to be funded in the event the trustor's situation changes, perhaps due to a decline in health or for other reasons. This approach can be particularly powerful when combined with the use of beneficiary designations to cause assets to be transferred to the trust outside of probate upon the trustor's death. (See E. Funding the Revocable Trust for further discussion of this point.) Because it can be used to accomplish almost all that a Will can but also can be used while the client is alive and can be used to avoid probate, a revocable trust is more flexible and useful than a Will.

Need for Pour Over Will

Even when a revocable trust is used, a Will is necessary. It usually takes the form of what is commonly referred to as a "pour-over Will" meaning that the Will simply provides that any probate assets are to pass—or "pour over"—to the revocable trust. The Will becomes a backstop to direct into the trust all the client's assets that were not transferred in during the client's lifetime or that do not pass to the trust by beneficiary desingation. A pour-over Will is usually very short and simple.

Guardian of Minor Appointed by Will

Another reason to have a Will, even when a revocable trust is used, is to nominate a guardian for any minor children of the client. §72-5-211, M.C.A. provides for the parent of an unmarried minor to appoint a guardian by Will, but does not mention appointment by trust. It may be that the court would give equal weight to a parent's appointment of a guardian through the parent's trust, but the more certain practice is to make the appointment through a Will.

5. When to Use a Revocable Trust Instead of a Will

Avoid Probate

Revocable trusts, at the death of the trustor, pass assets outside of the probate system. That is an important reason for the increased popularity of revocable trusts. A search on Amazon.com lists pages of books for sale dealing with the topic of using living trusts to avoid probate, so it obviously is a topic of interest to the general public. Some states do have burdensome probate procedures, with California often being mentioned as

one, and California was a leader in making revocable trusts popular. In states with the Uniform Probate Code, which allows for informal probate, and other states with simplified procedures, probate need not be difficult, yet whether deserved or not, probate is perceived by a large part of the public as something to be avoided.

In order to achieve this purpose, the trust either has to be fully funded during the trustor's life, beneficiary designations have to cover all the trustor's assets that would otherwise go through probate, or assets have to pass through joint tenancy, or a combination. *See* **E. Funding the Revocable Trust**, below. Otherwise, a probate will be subject to probate absent the availability of a probate substitute such as Montana's statute allowing collection of personal property by affidavit, §72-3-1101.

Avoid Ancillary Probate

For clients who own real property in multiple states, an ancillary probate will usually be necessary in the non-domiciliary states where the client owns real property. If, however, the client conveys all out-of-state real property to the client's trust, then upon the client's death, no ancillary probate will be required because the real property is in the trust and passes outside of probate.

Privacy

Frequently, proponents of living trusts claim that they provide greater privacy than a Will. A probated Will is a public record, open to inspection by the public. Upon a trustor's death, the revocable trust does not have to be filed with the court and thus the claim of greater privacy.

In practice, however, when a trustor wishes to open a bank account in the name of the trust or a brokerage account, it is common for the bank or brokerage to ask for a copy of the trust agreement. This is not the practice of financial institutions with regard to Wills, so the claim that trusts provide greater privacy is suspect. Some clients just hand over a copy of their trust, but they are not required to do so. The Montana Uniform Trust Code provides that instead of furnishing a copy of the trust instrument to a person other than a beneficiary, the trustee may furnish to the person a certification of trust containing the following information:

- that the trust exists and the date the trust instrument was executed:
- the identity of the trustor;
- the identity and address of the currently acting trustee;
- the revocability or irrevocability of the trust and the identity of any person holding a power to revoke the trust; and
- the authority of cotrustees to sign or otherwise authenticate and whether all or less than all are required in order to exercise powers of the trustee.

A certification of trust must state that the trust has not been revoked, modified, or amended in any manner that would cause the representations contained in the certification of trust to be incorrect, but it need not contain the dispositive provisions of the trust. There are additional requirements for a certification of trust with which the drafter should become familiar before preparing one, but it is important to know that a copy of the entire trust need not be provided. There is one important exception to this last statement: this statute does not limit the right of a person to obtain a copy of the trust instrument when required to be furnished by law or in a judicial proceeding concerning the trust. §72-38-1013(9), M.C.A.

Another way of handling this issue, that the author has started to use, it to redact a copy of the trust agreement so that nothing shows regarding beneficiaries, shares, and other private information. Financial institutions have been willing to accept redacted copies. With pdf editing software, such as PDFill which is very good and very inexpensive (and can be downloaded at www.pdfill.com), redacting a pdf copy of a trust agreement is quick and easy.

Probate Avoidance PLUS Trust During Life PLUS Simplicity

Probate avoidance by itself may be of limited benefit as a reason for using a revocable trust. But the choice of using a revocable trust becomes more compelling when the following factors are weighed:

- If the revocable trust is used in such a manner that probate is avoided, there is that benefit.
- The revocable trust is available if needed to administer the client's financial

affairs during lifetime.

- If that need never materializes, then by the use beneficiary designations naming the revocable trust as beneficiary, the client may continue to own assets in the client's own name but still avoid probate.
- Using the revocable trust as the designated beneficiary of the client's assets restores order to the potential chaos created by having multiple assets each with its own beneficiary designation, coordinates funding for such things as the credit shelter trust (if used) and simplifies making any changes in the future. See, E. 4 Designating the Revocable Trust as Beneficiary, below.
- If none of the planning is done to either transfer assets into the while the client is alive or by use of beneficiary designations, then the client is basically in the same position as having just a Will. Any probate assets will pass to the revocable trust under the terms of the pour-over will and will be distributed from there. That provides no advantage over having just a Will, but it is no disadvantage either. The client is no worse off. There is an upside, but no downside.

With the combined potential benefits of avoiding probate, the simplicity of the unfunded revocable trust with beneficiary designations, having the revocable trust available in case it is needed during the client's lifetime, and its use for the centralization and coordination of the client's assets, the revocable trust becomes a compelling choice over a Will.

6. Is Probate Avoidance Desirable?

It should not be assumed that avoiding probate is desirable. As with all estate planning, probate avoidance is a technique to be used only after considering the particular situation of the client. The probate system has features that may be important to some clients.

Creditor Claims

It may be advisable for the client's estate to pass through probate to cut off claims of creditors, particularly for a professional (such as a doctor, lawyer, engineer, or CPA). In Montana, creditors are required to file claims within 4 months after notice to creditors

has been published in a newspaper of general circulation or their claims will be forever barred. §72-3-801, M.C.A. For any known creditors, the time to submit claims can be shortened by giving written notice by mail or other delivery; in that case the creditor has 30 days from the mailing or delivery of the notice to file its claim or be forever barred. The written notice must give the known creditor until the <u>later</u> of the 4 month deadline for notice by publication or the 30 day deadline for notice by mailing or delivery. Although the statute imposes no requirement of giving written notice to known creditors, the failure to do so is inadvisable. In *Tulsa Professional Collection Services, Inc., vs. Pope*, 485 U.S. 478 (1988), the executrix had published notice to creditors in compliance with Oklahoma's probate code and the probate court had barred the claim of a creditor who had not timely filed. The U.S. Supreme Court held that the Due Process Clause of the 14th Amendment protected a creditor from having its claim barred by publication of notice when the creditor is known or "reasonably ascertainable." The Court held that due process requires that notice to such a creditor be given by mail or such other means as is certain to ensure actual notice.

Unless these time limits apply to provide an earlier bar date or some other statute of limitations provides an earlier bar, creditors fall under the general nonclaim statute, §72-3-803, M.C.A., which provides that all claims against a decedent's estate that arose <u>before</u> death are barred unless presented within 1 year after the decedent's death. In other words, one year from the decedent's death is the general bar date for claims arising before death. This bar date as to unknown creditors can be reduced to 4 months through publication of notice in a newspaper of general circulation and as to known creditors to the later of 30 days from written notice or 4 months from publication. That ability to shorten the time to present claims may for some clients be an important consideration.

Note that for claims against the decedent's estate that arise <u>at or after the date of death</u>, different time limits apply. In general, the creditor has only 4 months to file a claim on a contract with the Personal Representative or on any other claim within 4 months after it arises, or 1 year after the decedent's death.

Homestead Allowance

The surviving spouse or the minor and dependent children of a decedent are entitled to a homestead allowance of \$20,000. The homestead allowance is exempt from and has priority over all claims against the estate. §72-2-412 M.C.A.

Exempt Property

In addition to the homestead allowance, the surviving spouse or surviving children of the decedent are entitled to value not exceeding \$10,000 in excess of any security interests in household furniture, automobiles, furnishings, appliances, and personal effects. \$72-2-413, M.C.A.

Family Allowance

In addition to the homestead allowance and the exempt property allowance, the surviving spouse and children being supported by the decedent are entitled to a reasonable allowance in money out of the estate for their maintenance during the period of administration. §72-2-414 M.C.A.

The family allowance may not continue for more than 1 year.

The family allowance is exempt from and has priority over all claims except the homestead allowance.

The family allowance does not, in general, reduce the share of the decedent's estate passing to the surviving spouse or children.

Court Supervision

In even an informal probate, an inventory of assets and accounting by the Personal Representative is required. This helps to assure that the property of the decedent is properly administered and distributed. By its nature, probate is designed with safeguards to assure that the probated Will was validly executed, that notice is given to all interested persons, that creditors are given notice, and that the assets of the estate are properly inventoried, accounted for and distributed.

Revocable trusts have less formality. In many states, they may be executed with no witnesses and need not meet other requirements that apply to Wills. In general, following the trustor's death, they can be distributed more quickly than can a decedent's probate estate. This is part of the attraction of revocable trusts as well as other nonprobate devices.

Resort to the courts may be had for the enforcement of revocable trusts, but in many instances the procedural framework is not as well developed as for probates of Wills.

B. Credit Shelter Trusts

1. Tax Benefit of Credit Shelter Trusts

Credit shelter trusts may be created under a Will or a revocable trust. For years, they have been a staple of estate planning. They are so named because they are drafted to be funded with an amount calculated to exhaust the decedent's remaining unified credit.² These usually use a formula that divides a decedent's residuary into an amount covered by the unified credit, which then goes to the credit shelter trust, and any amount over that to the marital portion, which may either be outright or in a trust that qualifies for the marital deduction. The primary benefit of a credit shelter trust is that if properly drafted it can be used for the benefit of the surviving spouse but any assets in the trust at the death of the surviving spouse are not included in his or her estate for estate tax purposes, regardless of the value of the trust at that time.

As a result of the American Taxpayer Relief Act of 2012, the estate tax exemption was set at \$5 Million per person and indexed for inflation, so that now in 2013 the exemption is \$5.25 Million. In addition, portability was made permanent, a concept first introduced when Congress passed the Taxpayer Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010. In brief, portability allows the Personal Representative of a decedent's estate to allocate to a surviving spouse the decedent's unused exemption.

Example 1: Husband died in 2013 and made bequests of \$2.25 Million to his children, with the rest of his estate passing to Wife. Husband's Personal Representative filed an estate tax return allocating Husband's unused exemption of \$3 Million to Wife. Wife can now leave an estate of \$8.25 Million with no federal estate tax (\$5.25 Million

so after applying the credit, the estate tax is zero.

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² The unified credit is so "unified" because it applies to both the gift tax and the estate tax. To the extent lifetime gifts use up one's unified credit, there is less credit available for the estate tax. A decedent who dies in 2013 having made no lifetime taxable gifts could leave an estate of \$5.25 Million in a manner that did not qualify for either the marital or charitable deductions, with no tax. That is because the estate tax on \$5.25 Million is \$2,045,800, and the unified credit (applicable exclusion amount) for 2013 is \$2,045,800,

covered by Wife's own exemption and \$3 Million covered by Husband's unused exemption).

2. Credit Shelter Trusts in the New Estate Tax Environment

The estate tax exemption has steadily increased over the years. From 1942 through 1976, the exemption held steady at \$60,000. Then in 1977 the exemption was set at \$120,000 and increased steadily until in 2000 it was at \$675,000, an increase of somewhat more than \$24,000 per year. Under the Bush tax cuts, exemption became \$1,000,000 2002. the \$1,500,000 in 2004, \$2,000,000 in 2006, \$3,500,000 in 2009 and \$5,000,000 in 2011. As a result of the Bush tax cuts, the estate tax exemption increased more in the two years between the end of 2001 and the start of 2004 than it had in the prior 60 years. From 2001 until 2010, the increase in the estate tax exemption averaged over \$480,000 per year, 20 times the average increase between the years 1977 and 2000.

For many clients, this increase in the estate tax exemption combined with portability will make credit shelter trusts obsolete. If the deceased spouse leaves everything to the surviving spouse in a manner that qualifies for the marital deduction (and therefore does

Estate Ta	x Exemption
Year	\$ Exemption
1942-1976	60,000
1977	120,000
1978	134,000
1979	147,000
1980	161,000
1981	175,000
1982	225,000
1983	275,000
1984	325,000
1985	400,000
1986	500,000
1987-1997	600,000
1998	625,000
1999	650,000
2000-2001	675,000
2002-2003	1,000,000
2004-2005	1,500,000
2006-2008	2,000,000
2009	3,500,000
2010-2011	5,000,000
2012	5,120,000
2013	5,250,000

not use any of the deceased spouse's estate tax exemption), the surviving spouse can, with a properly filed election, have an estate of at least \$10.5 Million with no federal estate tax.³ Couples with estates in excess of that amount are a small portion of the population. But

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³ This assumes a decedent who dies in 2013 when the maximum DSUE amount is \$5.25 Million, which when combined with the surviving spouse's basic exclusion amount of \$5.25 Million gives the surviving spouse a \$10.5 Million applicable exclusion amount. The surviving spouse's basic exclusion amount will increase with inflation, but in any event could have an estate of at least \$10.5 Million with no estate tax.

before assuming that a credit shelter trust is not needed, take into account the following considerations:

- Potential Growth. There is no limit on the amount to which a credit shelter trust can grow without being taxable in the surviving spouse's estate. Contrast that with portability: the surviving spouse's estate tax exemption will be adjusted for inflation, but the deceased spouse's unused exemption (technically referred to as the "Deceased Spousal Unused Exclusion" or "DSUE") will not. The surviving spouse's "applicable exclusion amount" is the sum of the basic exclusion amount and the DSUE amount. In *Example 1*, the DSUE amount was \$3 Million, and there it will stay. The surviving spouse's basic exclusion amount will increase with inflation (I.R.C. §2010(c)(3)(B), but the DSUE amount will not. At a potential \$10.5 Million exclusion for the surviving spouse, many, many clients will feel safe that the survivor's estate will not be taxable and prefer portability to a credit shelter trust. Still, there was that client of mine who had been left some low-value ranch land in North Dakota that turned out to be in the Bakken oil patch. You just never know what the future holds. The safer bet is to put assets into a credit shelter trust. The simpler approach is to rely on portability. It's a judgment call in which the client should be involved and the decision memorialized.
- <u>The Next Spouse</u>. The deceased spousal unused exclusion may be lost on remarriage. It is only the unused exclusion of the *last deceased* spouse that can be used.
 - Example 2: Wife leaves everything to Husband, who ends up with a \$10.5 Million exclusion (\$5.25 Million of his own and \$5.25 Million of Wife's DSUE). It seems like good planning because between his own assets and what he inherited from Wife, Husband has \$7 Million of assets, well under the \$10.5 Million exemption now available to him. Husband still feels like he has some gusto left and ends up remarrying Wife 2 who has some considerable wealth of her own and, having listened to tax counsel has completely used up her estate

tax exemption making lifetime gifts to her children to get the appreciation out of her estate. Husband must have a dark cloud over him because Wife 2 runs off with the tennis pro and dies while snorkeling with the cad in the Bahamas. Unfortunately, Wife 2 has no DSUE left for her Personal Representative to allocate to Husband and the DSUE from Wife is lost, because Husband can only use the DSUE of the <u>last</u> deceased spouse. He dies with a \$7 Million estate but only \$5.25 Million of exemption, and at 40%, the tax on the excess is \$700,000, which could have been avoided if a credit shelter trust had been used at Wife's death instead of relying on portability. And this is the result with <u>no growth</u> in Husband's assets after Wife's death. To the extent the assets he received from Wife appreciate, the result becomes worse.

An Estate Tax Return is Required. Portability is available only if (i) the estate tax return is timely filed, (ii) the amount is computed on the return, and (iii) the Personal Representative makes an affirmative election that such amount may be taken into account by the surviving spouse. No portability election may be made if the estate tax return is filed after the time prescribed by law (including extensions) for filing such return. I.R.C. §2010(c)(5)(A). This is a potential trap for clients and their advisors who assume that because the estate of the first spouse is under the applicable exclusion amount, an estate tax return need not be filed. Contrast this to use of a credit shelter trust, which can be funded even without a federal estate tax return having been filed. Executors of estates that are not otherwise required to file an estate tax return (because the estate is less than the exclusion amount) do not have to report the value of certain property that qualifies for the marital or charitable deduction (Treas. Reg. §20.2010-2T(a)(7)(ii)(A)). To use this special rule, the Personal Representative must estimate the total value of the gross estate (including the values of the property that do not have to be reported on the estate tax return under this provision), based on a determination made in good faith and with due diligence regarding the value of all the assets includible in the gross estate (Treas. Reg. §20.20102T(a)(7)(ii)(B)).

- Statute of Limitations. The statute of limitations does not apply to the estate tax return of a deceased spouse for determinations with respect to the DSUE amount. I.R.C. §2010(c)(5)(B). In general, the statute of limitations is 3 years after the estate tax return is filed. I.R.C. §6501. If portability is not elected, after 3 years absent one of the statutory exceptions found in §6501(c) (false return, willful attempt to evade tax, no return, extension by agreement, etc.) the IRS will not be able to reopen that return after the 3 year period has run. A credit shelter trust might provide more definite protection against audit.
- Asset Management. Even if the credit shelter trust is not needed for estate tax planning purposes, one may be useful for purposes of asset management. The surviving spouse may have little experience in financial management, or little interest, or the deceased spouse may have children from a prior marriage and wants to provide for the surviving spouse but at the same time make certain the assets ultimately pass to the children of the deceased spouse. Not everything is tax-driven. There may be many reasons to have the assets held in trust, even if not for the purpose of estate tax planning.

3. Beware Tax Sensitive Powers

The whole tax purpose of a credit shelter trust is to avoid inclusion of the trust assets in the taxable estate of the surviving spouse. For that reason, it is especially important not to provide the surviving spouse with certain powers over the credit shelter trust that can result in its assets being taxable in the estate of the surviving spouse.

General Powers of Appointment

If the surviving spouse has a general power of appointment (created after October 21, 1942) over the credit shelter trust, its assets will be included in the taxable estate of the surviving spouse. I.R.C. §2041. The term "general power of appointment" means, in general, a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate, I.R.C. §2041(b)(1), and includes all powers which are in substance and effect powers of appointment regardless of what they are called, Treas. Reg. §20.2041-

1(b)(1). For example, if a trust instrument allows the surviving spouse to appropriate or consume the principal of the trust, that is a power of appointment. Treas. Reg. §20.2041-1(b)(1).

There are exceptions to this rule. For example, a power to consume, invade, or appropriate property for the benefit of the decedent which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent shall not be deemed a general power of appointment. I.R.C. §2041(b)(1)(A). A noncumulative annual power to invade principal limited to the greater of \$5,000 or 5% of the trust assets will not be treated as a general power of appointment. I.R.C. §2041(b)(2). Also, a power that may be exercised only in conjunction with another person who has a substantial adverse interest will not be treated as a general power of appointment. I.R.C. §2041(b)(1)(C)(ii).

The revocable trust may not expressly state that the surviving spouse has a general power of appointment over the credit shelter trust, but if, for example, the surviving spouse is both a trustee of the credit shelter trust and a beneficiary, the surviving spouse might be deemed to have a general power of appointment with the result being inclusion of the credit shelter trust assets in the taxable estate of the surviving spouse. The exclusion from the surviving spouse's estate may be saved by use of an "ascertainable standard" as mentioned in I.R.C. §2041(b)(1)(A). The regulations provide the following specific examples of what language will qualify as an "ascertainable standard": "[P]owers which are limited by the requisite standard are powers exercisable for the holder's 'support,' 'support in reasonable comfort,' 'maintenance in health and reasonable comfort,' 'support in his accustomed manner of living,' 'education, including college and professional education," "health," and "medical, dental, hospital and nursing expenses and expenses of invalidism." Treas. Reg. §20-2041-1(c)(2). It is risky to stray too far from these specific examples when drafting what are intended to be ascertainable standards.

Power to Remove and Replace Trustees

If the surviving spouse has the power to remove the trustee and appoint himself or herself as successor trustee, the surviving spouse may be treated as holding the powers of the trustee. Treas. Reg. §20.2041-1(b)(1). If the trustee is not limited to an "ascertainable standard" this could cause inclusion of the trust in the surviving spouse's estate.

If broad standards (that is, not ascertainable standards) are going to be provided to the trustee, it is best to specifically provide that the surviving spouse may not serve as trustee. Another possible solution is to provide that only independent trustees may serve. In many situations, however, the clients want the surviving spouse to be able to serve as trustee and so it will be imperative to use ascertainable standards over any discretionary distributions.

A Conservative Approach

In order to allow the surviving spouse to serve as trustee of the credit shelter trust and at the same time avoid inclusion of the credit shelter trust in the surviving spouse's taxable estate, the credit shelter trust can provide for mandatory distribution of all net income to the surviving spouse. If the trust may be invaded for the benefit of the surviving spouse, the invasion should be limited to an ascertainable standard. To permit additional flexibility, the surviving spouse may be given a 5 & 5 power under I.R.C. §2041(b)(2) (that is, noncumulative annual power to invade principal limited to the greater of \$5,000 or 5% of the trust assets).

There is no requirement that the income be distributed solely to the surviving spouse, but if distributions of net income to other beneficiaries in addition to the surviving spouse is to be permitted, there should be no discretion in the surviving spouse, acting as trustee unless limited to an ascertainable standard.

4. Joint Revocable Trusts

In common law states, there is a tax risk to using joint revocable trusts, by which is meant a single revocable trust for both the husband and wife. The use of joint revocable trusts was attractive because just one trust document is needed. But if the trust provides for a credit shelter trust to be created upon the first death, the risk is that the IRS will contend the surviving spouse has a retained interest in the credit shelter trust that runs afoul of any one or more of the provisions in I.R.C. §§2036-2038 (dealing with transfers with retained life estates, transfers taking effect at death, and revocable transfers), with the result

that the credit shelter trust has to be included in the surviving spouse's taxable estate, which is usually not the desired result. There is also a risk that to the extent the trust becomes irrevocable upon the death of the first spouse, the surviving spouse will be treated as having made a gift to the beneficiaries of the irrevocable trust. There is an additional issue with such a trust as to whether upon funding the trust with unequal contributions the spouse making the larger contribution will be treated as having made a gift to the other that does not qualify for the gift tax marital deduction.

With the higher estate tax exemption and portability, the inclusion of the entire trust in the taxable estate of the surviving spouse may actually be preferable. If the clients are convinced that there is no possibility of the total estate being more than the surviving spouse's "applicable exemption amount" (which in 2013 can be as high as \$10.5 Million), then there is no tax need for a credit shelter trust. Instead, a joint trust can be used and in most instances would be drafted in such a manner that purposely provides that the entire trust will be includible in the surviving spouse's taxable estate. As long as there is not going to be an estate tax to pay, the surviving spouse can have maximum flexibility over the trust assets as a trustee, with no concern about being limited by ascertainable standards. In addition, because the trust assets are includible in the surviving spouse's taxable estate, they get a full step up in basis at death. The assets in a credit shelter trust get a step up in basis at the death of the first spouse, but no additional step up in basis at the time of the surviving spouse's death.

As to the issue of a nonqualified marital gift at the time of funding, this is yet another reason to leave the trust unfunded during lifetime and have assets pass to the trust at death by beneficiary designations. But again, if the total estate is so far under the applicable exclusion amount that estate tax is a remote possibility, it may be a foul with no harm. In any event, an understanding of the gift and estate tax consequences is needed before making use of a joint revocable trust.

This arrangement may not be advisable in a second marriage where both the husband and wife have children from prior marriages, because the surviving spouse has almost complete control over the disposition of the trust assets. But in appropriate circumstances,

joint revocable trusts are now safer and more often indicated than they were a few years ago.

C. Marital Deduction Trusts

Marital deduction trusts are the complement to credit shelter trusts and, as with those, they can be created by a Will as well as by a revocable trust. On the death of the first spouse, the credit shelter trust is used to hold the assets that are covered by the estate tax exemption, but if the estate exceeds that amount, the only way to avoid an estate tax is either through charitable bequests or bequest to a surviving spouse. The latter may be an outright bequest, or a bequest in trust as long as the trust meets the requirements for obtaining a marital deduction under I.R.C. §2506. There is no limit on the amount of the marital deduction that may be allowed, as long as the requirements of §2056 are met.

The marital deduction applies to any interest in property which passes "or has passed" from the deceased spouse to the surviving spouse.

The marital deduction is only for the <u>net</u> value of interests in property passing to the surviving spouse. Consequently, any estate or inheritance taxes will reduce the marital deduction to the extent they affect the net value of the interests passing to the surviving spouse, I.R.C. §2056(b)(4)(A); and encumbrances against the property will reduce the amount of the marital deduction to the extent they affect the net value of the interests passing to the surviving spouse. I.R.C. §2056(b)(4)(B).

1. Conditions to Obtain the Estate Tax Marital Deduction

Property Included in Estate

The interest in property passing to the surviving spouse must be included in determining the value of the decedent's gross estate. I.R.C. §2056(a).

Passing Requirement

The interest must pass *from* the deceased spouse *to* the surviving spouse. §2056(a). The Code I.R.C. §2056(c). specifies seven means by which an interest in property will be treated as passing from the deceased spouse to the surviving spouse, two of which are by Will and by power of appointment (i.e., the decedent had a power, either alone or in conjunction with any person, to appoint such interest and if he appoints or has appointed such interest to the surviving spouse, or if the surviving spouse takes such

interest in default on the release or non-exercise of such power), which covers revocable trusts.

If at the time of the decedent's death it is not possible to ascertain the particular person or persons to whom an interest in property may pass from the decedent, such interest shall be considered as passing from the decedent to a person other than the surviving spouse. I.R.C. §2056(c). There are two exceptions to this rule: first, a life estate with power of appointment in the surviving spouse; and second, life insurance or annuity payments with power of appointment in the surviving spouse.

Surviving Spouse

The property must pass to the decedent's "spouse" who must survive the decedent.

Citizen Spouse

The surviving spouse must be a U.S. citizen unless a QDOT (Qualified Domestic Trust) is used. §2056(d)(1). QDOT's are treated under the general topic of **Trusts Used** for **Tax Reduction** later in this outline.

No Double Deduction

The interest must be not be deductible either under §2053 (i.e., for funeral expenses, administration expenses, claims against the estate, and indebtedness in respect of property included in the value of the gross estate) or §2054 (i.e., for losses during administration). Such an interest is deductible under those code sections, not under §2056.

Not a Nondeductible Terminable Interest

In general, if the interest is "terminable," a deduction will not be allowed. A "qualified" terminable interest *is* deductible though, and so are certain other forms of terminable interests.

A "terminable interest" in property is an interest which will terminate or fail on the lapse of time or on the occurrence or the failure to occur of some contingency. Life estates, terms for years, annuities, patents, and copyrights are therefore terminable interests. Treas. Reg. §20.2056(b)-1(b).

A property interest passing to a decedent's surviving spouse <u>is</u> deductible, Treas. Reg. §20.2056(b)(-1(d), even though it is a terminable interest, and even though an interest

therein passed from the decedent to another person, if it is a terminable interest only because—

- It is conditioned on the <u>spouse's surviving for a limited period</u>, in the manner described in Treas. Reg. §20.2056(b)-3 (i.e., the spouse is required to survive for no more than 6 months and does in fact survive the required period);
- It is a right to <u>income for life with a general power of appointment</u>, meeting the requirements set forth in Treas. Reg. §20.2056(b)-5;
- It consists of life insurance or annuity payments held by the insurer with a general power of appointment in the spouse, meeting the requirements set forth in Treas. Reg. §20.2056(b)-6;
- It is <u>qualified terminable interest property</u>, meeting the requirements set forth in Treas. Reg. §20.2056(b)-7;
- It is an interest in a <u>qualified charitable remainder trust</u> in which the spouse is the only non-charitable beneficiary, meeting the requirements set forth in Treas. Reg. §20.2056(b)-8.

2. The Outright Marital Bequest vs. a Marital Trust

An outright bequest to the surviving spouse will qualify for the marital deduction—as long as it is not subject to a nondeductible form of terminable interest—but places the property outside the control of the decedent. The surviving spouse is not obligated to dispose of the property in any particular fashion. In many cases, that is perfectly acceptable. But the clients should consider possible disadvantages of an outright bequest:

Financial Acumen of Surviving Spouse

If the surviving spouse has never handled money, a bequest in trust may be preferable.

Second Marriage

If the decedent spouse has children by a prior marriage, there may be concern that the surviving spouse might not leave the property to the children of the decedent spouse.

The Next Spouse

The surviving spouse may remarry. Even if the surviving spouse has a Will leaving everything to the children of the decedent spouse and the surviving spouse, the new spouse will have a right to elect against the Will. Property held in trust for the surviving spouse would not be subject to election.

3. Forms of Marital Trusts

Estate Trust

With this form of trust, income is payable to the surviving spouse for a term of years, or for life, or is to be accumulated, with all of the undistributed trust property passing to the surviving spouse's executor or administrator at her death. Rev. Rul. 68-554, 1968-2 C.B. 412. This is the only form of trust qualifying for the estate tax marital deduction that does not require annual payment of all trust income to the surviving spouse for life.

Life Interest General Power of Appointment Trust I.R.C. §2056(b)(5)]

There are 5 requirements to obtain a marital deduction when this form of trust is used (Treas. Reg. §20.2056(b)-5(a)):

- 1. The surviving spouse is entitled for life to <u>all of the income</u> from the entire interest, or a specific portion of the entire interest, or to a specific portion of all the income from the entire interest;
- 2. The income is payable to the surviving spouse <u>annually</u> or at more frequent intervals;
- 3. The surviving spouse is given the <u>power to appoint</u> the entire interest or the specific portion to himself or herself or to his or her estate;
- 4. The power is <u>exercisable by the surviving spouse alone</u> and (whether exercisable by will or during life) must be exercisable in all events; and
- 5. The entire interest or the specific portion is <u>not subject to a power in any other</u> person to appoint any part to any person other than the surviving spouse.

There is no requirement that the interest be in trust, but as a practical matter, it will be

One notable feature of this form of trust is that no election is required in order to obtain the marital deduction.

Qualified Terminable Interest Property Trusts I.R.C. §2056(b)(7)]

This form of trust does in fact create a terminable interest such that a bequest to it would be nondeductible but for the statutory provisions that allow a deduction as a "qualified" terminable interest. This topic is discussed in more detail below.

D. Qualified Terminable Interest Trusts (QTIPs)

1. Control Over Ultimate Disposition of Trust Property

Since its introduction in 1981, the Qualified Terminable Interest Property (QTIP) trust has been a popular form of marital trust. With a QTIP trust, the surviving spouse is entitled to income for life—as with the general power of appointment trust—except the spouse need not be given any control over the ultimate disposition of the property. The decedent spouse controls ultimate disposition of the property.

2. Elective

Another important feature of the QTIP trust is that it is <u>elective</u>. The Personal representative can claim this election with respect to <u>part or all</u> of the property.

3. Requirements

§2056(b)(7) imposes four basic requirements:

- the property must "pass" from the deceased spouse to the surviving spouse;
- the surviving spouse must have a qualifying income interest for life;
- no other beneficiary may have any rights in the trust during the lifetime of the surviving spouse; and
- an irrevocable QTIP election must be made.

Qualifying Income Interest for Life

The surviving spouse has a qualifying income interest for life if (i) the surviving spouse is entitled to all the income from the property, payable annually or at more frequent intervals, or has a usufruct interest for life in the property, and (ii) no person has a power to appoint any part of the property to any person other than the surviving spouse. \$2056(b)(7)(B)(ii).

Note that there is no requirement to provide that the principal be subject to inva-

sion for the benefit of the surviving spouse, although such a provision may be used if desired.

4. Specific Portion

A specific portion of property shall be treated as separate property. §2056(b)(7)(B)(iv).

5. Tax Treatment in Estate of Surviving Spouse

What Congress gives it can take away. A QTIP Trust may be used to save taxes at the death of the first spouse, but any assets in the QTIP Trust at the death of the surviving spouse will be included in the survivor's taxable estate. This is completely consistent with what would happen with an outright marital bequest: the surviving spouse would then own the bequeathed assets and unless they were spent would count as part of the survivor's taxable estate at death. Because of this, there is a tax bias in favor of spending assets for the benefit of the surviving spouse from the QTIP trust rather than from the credit shelter trust or some other source. Whatever is in the credit shelter trust at the death of the surviving spouse is not includible in his or her taxable estate, but whatever is in the QTIP trust is includible. The strategy is clear: deplete the QTIP trust and other assets of the surviving spouse before invading the credit shelter trust or some other available source, and language to this effect is frequently included when drafting a trust or will that includes both a QTIP trust and a credit shelter trust. As always, this comes with a caveat: there may be non-tax reasons not to invade the QTIP Trust first.

Example 3: The QTIP trust holds the controlling interest in a closely held business. If the QTIP Trust is required to be exhausted before the credit shelter trust is invaded, the QTIP Trust will have to dispose of the controlling interest in the business, which may be a significant detriment.

E. Funding the Revocable Trust

1. To Fund or Not to Fund

It has been fairly standard advice to instruct clients that if they are going to use a revocable trust, it should be funded. That is, bank accounts should be opened for the trust, personal property should be assigned to the trust, real estate deeded to the trust, and in general, all assets of the trustor conveyed into the trust. Often, the purpose of creating a

revocable trust in the first place is to avoid probate and if the trustor does not transfer all assets to the trust, then a probate may be needed to get the assets into the trust. By not fully funding the trust, the thinking goes, the probate avoidance purpose will be frustrated. Once the trust is funded, the trustor administers the trust assets as long as the trustor is able, and then those duties fall to a successor trustee.

Another approach has been suggested that leaving the trust unfunded is in fact more appropriate for many clients. See, Baskett, A Second Look at Living Trusts, The Montana Lawyer, Vol. 36, No. 7 (May 2011). The key to this approach is to use the trust as the designated beneficiary of the various assets that can pass by beneficiary designation. The trust then is the central gathering point for all these assets and because they pass by beneficiary designation, they still pass outside of probate. In the meantime, the trustor owns and uses the assets in the trustor's own name, as the trustor always has, and does not have to deal with assets through the trust. Should the time come when it would be useful to have a successor trustee administer the assets (e.g., the trustor's health may decline or the trustor simply may not wish to continue having responsibility for financial management), then assets can be transferred into the trust, but if that time never comes, then upon the trustor's death all the assets pass to the trust by beneficiary designation, without going through probate. This achieves the goal of avoiding probate and at the same time, keeping matters simple for the client. So, the primary plan is that assets would not be transferred into the trust, but beneficiary designations would be used such that upon the trustor's death the assets pass into the trust without having gone through probate, but the contingency plan is that if the need arises, assets will be transferred into the trust during the trustor's lifetime so that the successor trustee can assume management of the trust.

2. Beneficiary Designations

Beneficiary designations are available for many assets. Bank accounts can have a "Payable on Death" beneficiary designation. Security accounts can have a "Transfer on Death" beneficiary designation. A nonprobate transfer can also be provided in an insurance policy, contract of employment, bond, mortgage, promissory note, certificated or uncertificated security, account agreement, custodial agreement, deposit agreement, compensation

plan, pension plan, individual retirement plan, employee benefit plan, trust, conveyance, deed of gift, marital property agreement, or other written instrument of a similar nature. See §72-6-111, M.C.A. And beginning in 2007, real property in Montana can be conveyed in a nonprobate transfer by a beneficiary deed. §72-6-121, M.C.A.

3. Beneficiary Designations vs. Joint Tenancy

Similarities and Differences

Both joint tenancy and beneficiary designations are used to transfer property outside of probate. There are important differences to consider when choosing which to use.

Ownership: Property titled in joint tenancy has multiple owners, and each has a right to use the property. With a beneficiary designation, the beneficiary has no property interest until the death of the property owner. The owner can change beneficiaries, sell the property, encumber it, or give it away, all without any need to get consent from, or even consult with, the beneficiary.

Gift: Titling property in joint tenancy creates a gift. For real estate, the gift is immediate. For intangible personal property, such as bank accounts, the gift occurs when the done withdraws the funds.

Gift Back: If the donee dies before the donor, there is a gift from the donee back to the donor, unless it can be adequately established that property actually came from the donor.

Creditors: If the donee has creditors, they may attempt to execute against the property.

Disputed Intent: A common issue arises when a parent adds a child to a joint bank account:

Example 4: Mother has a large checking account. She is concerned she may soon be unable to pay her own bills, so she converts the account to a joint checking account and adds Child 1 as the other tenant on the account. Child 1 lives nearby and it is more convenient for her to tend to Mother's affairs than it is for Child 2 and Child 3 who live far away. All goes well until Mother dies and the account passes to Child 1, who believes that was Mother's intention all along. Child 2 and Child 3 think the account was put in joint

tenancy just for convenience in paying Mother's bills and that Mother did not intend Child 1 to take it all. After all, Mother's revocable trust provides that everything else is to be shared equally by all three children.

If Mother really did intend all three children to share the checking account equally upon her death, she could have avoided this dispute by giving Child 1 signature authority on the account without making Child 1 a co-owner of the account.

Tax Factors

Beneficiary Designations

With a beneficiary designation, no transfer has occurred and will not occur until the death of the owner. At that time, the asset will count as part of the owner's taxable estate but will not be included in the owner's probate estate; the asset passes as a nonprobate transfer.

Joint Tenancy – Estate Tax

The decedent's gross estate will include one-half the value of any property held by the decedent and the decedent's spouse as joint tenants. Treas. Reg. §20.2040-1(c)(7).

If the decedent owned the property in joint tenancy with someone other than the decedent's spouse, the IRS will presume that the full value of the property will be included in the decedent's estate, not just the decedent's proportional interest. Treas. Reg. \$20.2040-1(a)(2). This presumption may be rebutted by evidence establishing that consideration for the property came from someone other than the decedent.

Joint Tenancy - Gift Tax

The creation of a joint tenancy may be a taxable gift. The regulations distinguish between financial accounts and other assets. Creation of a joint tenancy in a bank account will not be considered a gift until such time as the money is withdrawn by the donee. Treas. Reg. §25.2511-1(h)(4). Creation of joint tenancy in land, however, will be considered a gift as of the execution and delivery of the deed unless it is between a husband and wife. Treas. Reg. §25.2511-1(h)(5).

Joint Tenancy – Potential Double Taxation?

Creating joint tenancies in land other than between a husband and wife could result in double taxation. If a parent adds a child as a joint tenant to land owned by the parent,

there is a completed gift upon execution and delivery of the deed. Treas. Reg. §25.2511-1(h)(5). In addition, because the parent provided all the consideration for the land, upon the parent's death, 100% of the value of the land would be includible in the parent's taxable estate. Treas. Reg. §20.2040-1(a)(2).

Hidden Joint Tenancy

Montana's statutes on multiple party accounts provide a form of "hidden" joint tenancy. Under §72-6-212, M.C.A., on the death of a party,

- sums on deposit in a multiple-party account belong to the surviving party or parties;
- if two or more parties survive and one is the surviving spouse of the decedent, the amount to which the decedent, immediately before death, was beneficially entitled under §72-6-211, M.C.A. belongs to the surviving spouse (§72-6-211, M.C.A. provides in general that parties own the account in proportion to contributions except that married parties are presumed to be entitled to equal shares); and
- if two or more parties survive and none is the surviving spouse of the decedent, the amount to which the decedent, immediately before death, was beneficially entitled under §72-6-211, M.C.A. belongs to the surviving parties in equal shares and augments the proportion to which each survivor, immediately before the decedent's death, was beneficially entitled under §72-6-211, M.C.A. and the right of survivorship continues between the surviving parties.

An account can provide that it is without right of survivorship, §72-6-212(3), M.C.A., in which case the above rules would not apply. If an account form similar to the one provided by statute (*See* **E.7 POD Designations** – **Forms**, below), is used, it should be clear whether the account is to have right of survivorship or not.

4. Designating the Revocable Trust as Beneficiary

As discussed above in **E1. To Fund or Not to Fund**, rather than funding the revocable trust while the client is alive, it may be preferable to leave the trust unfunded but use beneficiary designations to pass assets outside of probate to the trust at the trustor's

death. Then the client is not required to deal with assets through the trust. Clients just like that simplicity. The client's checking account is in the client's name, not the trust's. But with a POD designation, the checking account can pass into the client's trust at death and outside of probate.

Tangible Personal Property

There are some assets that cannot have beneficiary designations. How to handle furniture, artwork, and jewelry? Tangible personal property is one category of assets that may best be transferred to the trust by bill of sale. Those assets aren't likely to generate income or require administration, so even if no other assets are transferred to the trust at the time of execution, it can be helpful to have the trustor sign a bill of sale assigning items of tangible personal property to the trust.

Financial Assets

Financial accounts can often be left in the client's name, but by the use of POD designations for bank accounts and TOD designations for security accounts, they also can be held in the client's own name while alive, but transfer outside of probate to the trust upon death. The use of these beneficiary designations is discussed below at **E.7 POD Designations** and **E.8 TOD Registrations**.

Real Estate

Since 2007 in Montana, real estate can pass by beneficiary designation. That was not possible before then. This is accomplished by use of a beneficiary deed, which is discussed in more detail in **E. 9 Beneficiary Deeds** below.

Life Insurance

Life insurance is one of the oldest examples of the use of beneficiary designations. Rather than designate an individual as the beneficiary of the policy, consider designating the revocable trust.

5. How to Take Title in the Name of the Trust

Technically, trusts do not own assets, trustees do. Trusts are not entities like corporations. The relationship is that the trustee takes legal title to property, but is required to use it for the benefit of the beneficiary. Bare legal title to property is split from the bene-

ficial interest in the property. The owner of the property "trusts" the trustee with the property for the benefit of the beneficiary. Technically, then, if Client were to transfer real estate to himself as trustee of his revocable trust, the conveyance would be from "Client to Client as Trustee of the Client Revocable Trust." Things become a little more complicated when the transfer is to occur by beneficiary designation upon Client's death, because obviously Client will not be Trustee at that time. Preferably, the beneficiary would be designated as the "Successor Trustee of the Client Revocable Trust," but this person cannot be identified because there is no certainty who that successor trustee will be at the time of Client's death, unless the successor trustee is a corporate trustee, but that is not common. From personal experience, the author knows that when a beneficiary deed is recorded, if it simply designates the "successor trustee" as the beneficiary, the Montana Department of Revenue will object. As an alternative approach, the author has found that designating "Client as Trustee of the Client Revocable Trust (or any Successor Trustee serving at the death of Client)" seems to pass muster.

Another approach is to rely on §72-38-1111(8), M.C.A., which provides that, "The designation of the name of a trust in a recorded conveyance vests the estate in the trustee of the trust. A subsequent conveyance may be made by the trustee. The identity of a party serving as trustee may be established by a recorded affidavit of the party or by another recorded instrument specifying the trustee's name and address and confirming that the party is currently serving as the trustee." Using this, the conveyance could be simply from "Client to the Client Revocable Trust." Note, however, that this statute applies only conveyance of real property, and does not by its terms apply to other assets.

6. Beneficiary Designations Naming Individuals vs. Naming the Revocable Trust

All of the beneficiary designation techniques mentioned above and discussed in more detail below can be used to name individuals as beneficiaries; they do not have to be used to name the revocable trust as beneficiary. But there are often good reasons why the named beneficiary should be the trust, not the individuals.

Beneficiary designations have to be used with care, otherwise they can result in unintended consequences, or have impacts not thought about in the first place. A particular

danger is that there may be a different form used for each financial asset that has a beneficiary designation and if they are not coordinated with the client's overall objectives, the entire estate plan may be frustrated. The revocable trust provides a means of coordinating all these beneficiary designations. If the revocable trust is the designated beneficiary of all the financial assets, then all those financial assets can flow to the trust at the trustor's death, and the trust can provide all the needed coordination.

Example 5: Mom and Dad have three children, Child 1, Child 2 and Child 3. They want their children to share everything equally, and when they become aware that a bank account can pass to their children by a POD designation without having to go through probate, they set all their bank accounts up that way. Upon the death of the survivor of Mom and Dad, the accounts all pass to the three children in equal shares, just as Mom and Dad had intended.

Failure to Provide Contingent Designations:

Example 6: Same as **Example 5**, but unfortunately, Child 3 dies before Mom and Dad not survive Mom and Dad they have not designated a contingent beneficiary. Should Child 3's share pass to Child 3's children? Or perhaps to Child 1 and Child 2, to Child 3's estate, or to the estate of the survivor of Mom and Dad? The POD beneficiary designation card at each bank may provide different results.

The Underage or Incapacitated Beneficiary:

Example 7: Same as **Example 6**, but Child 3 leaves a 4 year old child, Granchild 3.1. Under the terms of the POD designation, Child 3's share of the account passes to Grandchild 3.1 and since no other provision was made, the best that can be done is to have a custodian appointed to hold the rather substantial money in a Transfers to Minors Account, but that cannot continue beyond age 21. Upon turning 21, Grandchild 3.1 has a nice new car.

Example 8: Same as **Example 7**, but instead of designating the three children as beneficiaries, Mom and Dad designate their revocable trust as beneficiary. The revocable trust provides that in general the residuary is to be divided equally by their three children and if a child does not survive them, the deceased child's share is to pass to the deceased

child's issue per stirpes, but if any such issue is then under the age of 30 years, their share will be held in trust to be used for college education and other purposes important to Mom and Dad.

Changing Circumstances:

Example 9: Mom and Dad have a POD designation on each of their four bank accounts, a TOD designation on each of their three brokerage accounts, and have named beneficiaries on their two life insurance policies. In each case, after the survivor dies, the asset is to be divided into equal shares for each of their three children. Child 2 has just sold her software company to Google for \$9 Billion and doesn't really need anything more from Mom and Dad. Child 1 and Child 3, though, could use extra. Mom and Dad have to change nine different beneficiary designations due to effect this change.

Example 10: Same as **Example 9**, but instead of designating their children as beneficiaries, for each of their bank accounts, brokerage accounts and life insurance policies, Mom and Dad had provided that on the survivor's death the beneficiary was their revocable trust. Now, when Child 2 strikes it rich, they just amend their revocable trust to exclude Child 2, instead of nine different beneficiary designations.

Failure to Coordinate for Credit Shelter Funding:

Often, for married clients, Wills and Revocable Trusts with estate tax planning features provide that the decedent's assets up to the estate tax exemption amount will be held in trust for the survivor, and will provide a formula to fund the credit shelter trust. But a client who uses beneficiary designations for a significant portion of his assets may inadvertently scuttle this planning. Often, the purpose of a credit shelter trust is to hold assets during the lifetime of the surviving spouse (and perhaps beyond) in a manner that they can be used to benefit the surviving spouse but then upon the death of the surviving spouse, are not then counted as assets includible in the taxable estate of the surviving spouse. The assets in the credit shelter trust can grow without limit after the death of the deceased spouse and still not be taxable in the estate of the surviving spouse. This obviously is a very desirable result. But through the use of beneficiary designations, there may not be any assets to fund the credit shelter trust (or at least not the optimum amount of assets).

Perhaps the surviving spouse has been the designated beneficiary of all those assets, and as a result ends up owning all assets of the couple. If that results in the surviving spouse having a taxable estate, it is an opportunity wasted at a significant cost. This issue has become less significant in the wake of the increase in the estate tax exemption and the availability of portability, but in the appropriate circumstances, underfunding the credit shelter bequest can be very costly.

7. POD Designations

One or More Owners of an Account May Designate One or More Beneficiaries

"A 'POD designation' means the designation of: (a) a beneficiary in an account payable on request to one party during the party's lifetime and on the party's death to one or more beneficiaries or to one or more parties during their lifetimes and on death of all of them to one or more beneficiaries; or (b) a beneficiary in an account in the name of one or more parties as trustee for one or more beneficiaries if the relationship is established by the terms of the account and there is no subject of the trust other than the sums on deposit in the account, whether or not payment to the beneficiary is mentioned." §72-6-201(8), M.C.A.

POD Designations Are Used for Bank Accounts:

"Account' means a contract of deposit between a depositor and a financial institution and includes a checking account, savings account, certificate of deposit, and share account." §72-6-201(1), M.C.A.

Some Accounts Cannot Have POD Designations:

POD designations cannot be used for –

- an account established for a partnership, joint venture, or other organization for a business purpose;
- an account controlled by one or more persons as an agent or trustee for a corporation, unincorporated association, or charitable or civic organization; or
- a fiduciary or trust account in which the relationship is established other than by the terms of the account.

§72-6-202, M.C.A.

POD Designations May be Used with Single Party or Multiple Party Accounts:

"An account may be for a single party or multiple parties. A multiple-party account may be with or without a right of survivorship between the parties." §72-6-203, M.C.A.

Accounts with POD Designations May upon Death of the Owner be Paid Directly to the Beneficiary:

"A financial institution, on request, may pay sums on deposit in an account with a POD designation to: (1) one or more of the <u>parties</u>, whether or not another party is disabled, incapacitated, or deceased when the payment is requested and whether or not a party survives another party; (2) the <u>beneficiary</u> or beneficiaries, if proof of death is presented to the financial institution, showing that the beneficiary or beneficiaries survived all persons named as parties; or (3) the <u>personal representative</u>, if any, or, if there is none, the <u>heirs or devisees</u> of a deceased party, if proof of death is presented to the financial institution, showing that the deceased party was the survivor of all other persons named on the account as either a party or beneficiary." §72-6-223, M.C.A. Notice that under (3), if there is a POD designation on an account, it appears an account can be paid directly to heirs or devisees even if a probate of the decedent's estate would otherwise be required under the Montana Uniform Probate Code.

The Beneficiary has no Ownership Interest in an Account While the Owner is Alive:

"A beneficiary in an account having a POD designation has no right to sums on deposit during the lifetime of any party." §72-6-211(3), M.C.A.

The Beneficiary has Transferee Liability for Claims Against the Owner's Estate:

"Except as otherwise provided by statute, a transferee of a nonprobate transfer is subject to liability to any probate estate of the decedent for allowed claims against the decedent's probate estate and statutory allowances to the decedent's spouse and children to the extent the estate is insufficient to satisfy those claims and allowances. The liability of a nonprobate transferee may not exceed the value of nonprobate transfers received or

controlled by that transferee." §72-6-228(2), M.C.A.

When the Beneficiary is a Trust and the Account Cash has been Distributed, the Beneficiaries Will Have Transferee Liability, Not the Trustee:

"A trustee receiving or controlling a nonprobate transfer is released from liability under this section with respect to any assets distributed to the trustss beneficiaries. Each beneficiary, to the extent of the distribution received, becomes liable for the amount of the trustee's liability attributable to assets received by the beneficiary." §72-6-228(9)(b), M.C.A. Note that this does not apply if before making the distribution the Trustee has received a written notice from the decedent's Personal Representative asserting that the decedent's probate estate is nonexistent or insufficient to pay allowed claims and statutory allowances. §72-6-228(9), M.C.A.

Forms:

§72-6-204, M.C.A. provides the following form, which can be used to establish the intended form of account:

..... SINGLE-PARTY ACCOUNT

..... MULTIPLE-PARTY ACCOUNT

Parties own account in proportion to net contributions unless there is clear and convincing evidence of a different intent. However, any one party may withdraw the entire amount on deposit in the account.

CHANGING TERMS OF ACCOUNT [Select One and Each Party Initial]:

..... MULTIPLE-PARTY ACCOUNT'S TERMS MAY BE CHANGED BY A SINGLE PARTY

..... MULTIPLE-PARTY ACCOUNT'S TERMS MAY BE CHANGED ONLY BY AGREEMENT OF ALL PARTIES

RIGHTS AT DEATH [Select One and Initial]:

..... SINGLE-PARTY ACCOUNT

At death of party, ownership passes as part of party's estate.

..... SINGLE-PARTY ACCOUNT WITH POD (PAY ON DEATH) DESIGNATION

[Name One or More Beneficiaries]:

.....

At death of party, ownership passes to POD beneficiaries and is not part of party's estate.

..... MULTIPLE-PARTY ACCOUNT WITH RIGHT OF SURVIVOR-SHIP

At death of party, ownership passes to surviving parties.

..... MULTIPLE-PARTY ACCOUNT WITH RIGHT OF SURVIVOR-SHIP AND POD (PAY ON DEATH) DESIGNATION

[Name One or More Beneficiaries]:

At death of last surviving party, ownership passes to POD beneficiaries and is not part of last surviving party's estate.

..... MULTIPLE-PARTY ACCOUNT WITHOUT RIGHT OF SURVIVORSHIP

At death of party, deceased party's ownership passes as part of deceased party's estate.

AGENCY (POWER OF ATTORNEY) DESIGNATION

Agents may make account transactions for parties but have no ownership or rights at death unless named as POD beneficiaries.

[To Add Agency Designation to Account, Name One or More Agents]:

.....

[Select One And Initial]:

- AGENCY DESIGNATION SURVIVES DISABILITY OR INCA-PACITY OF PARTIES
- AGENCY DESIGNATION TERMINATES ON DISABILITY OR INCAPACITY OF PARTIES

8. TOD Registrations

Specifics of the Uniform TOD Security Registration Act

Transfer on Death ("TOD") registrations are governed by the Uniform TOD Security Registration Act, Title 72, Ch. 6, Part 3, M.C.A. Though similar to POD designations, they are used for "securities" and "security accounts" as defined in §72-6-301, M.C.A.

How to Register

Registration in beneficiary form may be shown by the words "transfer on death" or the abbreviation "TOD", or by the words "pay on death" or the abbreviation "POD", after the name of the registered owner and before the name of a beneficiary. §72-6-305, M.C.A.

Securities Owned by Tenancy in Common Cannot Have a TOD Registration:

Only individuals whose registration of a security shows sole ownership by one individual or multiple ownership by two or more with right of survivorship, rather than as tenants in common, may obtain registration in beneficiary form. §72-6-301, M.C.A.

The Beneficiary has no Interest Until the Owner Dies:

As with POD accounts, the designation of a TOD beneficiary on a registration in beneficiary form has no effect on ownership until the owner's death, and a registration of a security in beneficiary form may be canceled or changed at any time by the sole owner or all then-surviving owners without the consent of the beneficiary. §72-6-306, M.C.A. Consequently, TOD accounts insulate the account owner from the claims of a beneficiary's creditors, at least as to the securities in the account.

At the death of the owner of the account, the securities pass to the beneficiary outside of probate, as they would if they had been owned in joint tenancy. If there are multiple beneficiaries, they hold their interests as tenants in common, until the securities are divided after the death of the owner. If no beneficiary survives the death of all owners, the security belongs to the estate of the owner. §72-6-307, M.C.A.

The Act provides the following examples of registration in beneficiary form:

- Sole owner-sole beneficiary: John S. Brown TOD (or POD) John S. Brown Jr.
- Multiple owners-sole beneficiary: John S. Brown Mary B. Brown JT TEN TOD John S. Brown Jr.
- Multiple owners-primary and secondary (substituted) beneficiaries: John S.
 Brown Mary B. Brown JT TEN TOD John S. Brown Jr. SUB BENE Peter Q.
 Brown or John S. Brown Mary B. Brown JT TEN TOD John S. Brown Jr. LDPS

In the last example, "LDPS" is abbreviation for lineal descendants per stirpes. §72-6-310(2).

TOD Registration for Closely Held Business Interests

The Uniform TOD Security Registration Act seems to have been drafted with brokerage accounts in mind, but could beneficiary registrations be used for ownership interests in a closely held business? There does not seem to be any reason against allowing

that. The Act refers to registering securities with a registering agent. But the definition of "security" is broad enough to include partnership interests, LLC membership interests or shares of stock in an S or C corporation. §72-6-301(4), M.C.A. A security, whether evidenced by certificate or account, is registered in beneficiary form when the registration includes a designation of a beneficiary to take the ownership at the death of the owner or the deaths of all multiple owners. §72-6-304, M.C.A. It appears that as long as the security has the necessary designation, it is "registered" and for most closely held businesses there is usually someone in charge of keeping records as to ownership of the business.

9. Beneficiary Deeds

Beneficiary deeds are of recent origin in Montana. Provision for them was made by the 2007 Legislature, and the statutory provision for them can be found at §72-6-121, M.C.A. Previously, outside of a trust, joint tenancy was the only method of nonprobate transfer for real property. With beneficiary deeds, a beneficiary may be designated who upon the property owner's death will receive the property outside of probate. The client's revocable trust may be used as the designated beneficiary; then, while the client is alive, the client continues to own and operate the property as before, but upon the client's death, the property passes into the revocable trust.

Conveyances and Encumbrances

A beneficiary deed transfers the deceased owner's interest to the grantee beneficiary designated by name in the beneficiary deed effective on the death of the owner, subject to all conveyances, assignments, contracts, mortgages, deeds of trust, liens, security pledges, and other encumbrances made by the owner or to which the owner was subject during the owner's lifetime. §72-6-121(1), M.C.A.

Multiple Beneficiaries

A beneficiary deed may designate multiple grantees who take title as joint tenants with right of survivorship, tenants in common, or any other tenancy that is valid. § 72-6-121(2), M.C.A.

Contingent Beneficiary

A beneficiary deed may designate a successor grantee beneficiary. §72-6-121(3), M.C.A.

Joint Tenants Can Jointly Designate a Beneficiary:

If real property is owned by persons as joint tenants with the right of survivorship, a deed that conveys an interest in the real property to a grantee beneficiary designated by <u>all</u> of the then-surviving owners and that <u>expressly states</u> that the deed is effective on the death of the last surviving owner transfers the interest to the designated grantee beneficiary effective on the death of the last surviving owner. §72-6-121(4), M.C.A.

Joint Tenancy Trumps a Beneficiary Designation:

If a beneficiary deed is executed by <u>fewer than all</u> of the owners of real property owned as joint tenants with right of survivorship, the beneficiary deed is valid if the last surviving owner is one of the persons who executes the beneficiary deed. If the last surviving owner did not execute the beneficiary deed, the transfer lapses and the deed is void. An estate in joint tenancy with right of survivorship is not affected by the execution of a beneficiary deed that is executed by fewer than all of the owners of the real property, and the rights of a surviving joint tenant with right of survivorship prevail over a grantee beneficiary named in a beneficiary deed. §72-6-121(4), M.C.A.

Record an Acknowledgment When the Owner Dies:

A surviving person with an interest in real property subject to a beneficiary deed as provided in this section may execute an acknowledged statement that another person with an interest in the property is deceased. The statement must contain those matters specified in §7-4-2613(1)(c), M.C.A. (which provides for the recording by the county clerk and recorder of an acknowledged statement describing real property and indicating that the holder of a nonprobate interest in real property is deceased and the holder's interest in the real property is terminated), and be recorded with the clerk and recorder in each county in which the real property or any part of the real property is located. §72-6-121(4), M.C.A.

A Beneficiary Deed Has to be Recorded BEFORE the Owner Dies:

A beneficiary deed is valid only if the deed is executed and recorded, as provided by law, in the office of the county clerk and recorder of the county in which the property is located, before the death of the owner or the last surviving owner. §72-6-121(5), M.C.A.

Revocable Trusts are Permitted Beneficiaries:

A beneficiary deed may be used to transfer an interest in real property to the trustee of a trust even if the trust is revocable. §72-6-121(5), M.C.A.

A Beneficiary Deed May Be Revoked at Any Time:

A beneficiary deed may be revoked at any time by the owner or, if there is more than one owner, by any of the owners who executed the beneficiary deed. To be effective, the revocation must be executed and recorded, as provided by law, in the office of the county clerk and recorder of the county in which the real property is located, before the death of the owner who executes the revocation. If the real property is owned as joint tenants with right of survivorship and if the revocation is not executed by all the owners, the revocation is not effective unless executed by the last surviving owner. §72-6-121(6), M.C.A.

Medicaid Liens Follow the Property Into the Beneficiary's Hands:

If an individual who is a recipient of medicaid pursuant to §53-6-131, M.C.A. conveys an interest in real property by means of a beneficiary deed, the department of public health and human services may assert a claim pursuant to §53-6-167, M.C.A. against the property that is the subject of a beneficiary deed to the extent of medical assistance granted by the department. §72-6-121(7), M.C.A.

Later Beneficiary Deeds Supersede Prior Beneficiary Deeds:

If an owner executes and records more than one beneficiary deed concerning the same real property, the last beneficiary deed that is recorded before the owner's death is the effective beneficiary deed. §72-6-121(8), M.C.A.

The Beneficiary's Consent is not Required:

The signature, consent, or agreement of, or notice to, a grantee beneficiary of a beneficiary deed is not required for any purpose during the lifetime of the owner. §72-6-121(10), M.C.A.

A Beneficiary Deed Trumps a Will:

A beneficiary deed that is executed, acknowledged, and recorded in accordance with this section is not revoked by the provisions of a will. §72-6-121(10), M.C.A.

Record an Acknowledgment upon Death of an Owner:

The death of an owner of real property must, for the purposes of this section, be proved by an acknowledged statement that a person with an interest in the property is deceased. The statement must contain the matters specified in 7-4-2613(1)(c) and be recorded with the clerk and recorder in each county in which the real property or any part of the real property is located. §72-6-121(12), M.C.A. [Note: This appears to substantially duplicate the provisions found in §72-6-121(4), M.C.A.]

Beneficiary Deed Form:

A beneficiary deed is sufficient if it complies with other applicable law and if it is in substantially the following form (§72-6-121(13), M.C.A.):

Beneficiary Deed				
I (we) (owner) hereby convey to (grantee beneficiary) effective on my (our) death the following described real property:				
(Legal description)				
If a grantee beneficiary predeceases the owner, the conveyance to that grantee beneficiary must either (choose one):				
[] Become void.				
[] Become part of the estate of the grantee beneficiary.				
(Dated)				
(Signature of grantor(s))				
(acknowledgment)				

This form leaves something to be desired. The statute refers to the possibility of designating a contingent beneficiary, but this form indicates that if the primary beneficiary fails to survive the owner, there are only two options: the conveyance becomes void, or it becomes part of the estate of the grantee beneficiary. Most drafters would not consider that if the beneficiary failed to survive the owner, the property should pass to the beneficiary's estate. After all, the beneficiary might have died many years prior to the owner. It may be that the drafters of the statute intended the second option to be that the property

would become part of the estate of the <u>grantor</u>, but then again, that would lead to basically the same result as the first option, that the conveyance become void. In any event, the form is confusing. The author has included sample forms of his own in the section on **F. Drafting Tips and Samples** that follows.

10. Other Beneficiary Designations

Life insurance policies, annuities, retirement plans, all can have beneficiary designations. Retirement plans (including IRA's) merit special attention because of the minimum distribution rules and the special treatment afforded a surviving spouse that differs from all other beneficiaries.

F. Drafting Tips and Samples

1. Sample Beneficiary Deed to Owner's Revocable Trust Beneficiary Deed

THIS INDENTURE, Made by JOHN DOE , of Street Address, City, Montana Zip., PARTY of the FIRST PART, and JOHN DOE , TRUSTEE OF THE JOHN DOE 2012 TRUST U/A/DTD //20, (or any Successor Trustee of said Trust serving as of the death of the PARTY of the FIRST PART), of Street Address, City, Montana Zip, PARTY of the SECOND PART,			
WITNESSETH: That the said PARTY of the FIRST PART does hereby convey to the said PARTY of the SECOND PART effective on the death of the PARTY of the FIRST PART the following described real estate, situated in the County of and State of Montana, commonly known as, Montana, and more particularly described as follows:			
[Legal Description] Recording Reference:			
SUBJECT TO all conveyances, assignments, contracts, mortgages, deeds of trust, liens, security pledges, and other encumbrances made by the PARTY of the FIRST PART or to which the PARTY of the FIRST PART was subject during the lifetime of the PARTY of the FIRST PART.			
(Signature of Grantor) [acknowledgment]			

[acknowledgment]

2. Sample Beneficiary Deed for Jointly Owned Property to Pass to Revocable Trust of the Surviving Joint Tenant

BENEFICIARY DEED

THIS INDENTURE, Made by and between –

The PARTIES of the FIRST PART: **JOHN DOE** and **JANE DOE**, husband and wife, of Street Address, City, Montana Zip.

The PARTY of the SECOND PART referred to herein is **JOHN DOE**, **TRUSTEE OF THE JOHN DOE 2012 TRUST**, (or any Successor Trustee of said Trust serving as of the death of the surviving PARTY of the FIRST PART), of Street Address, City, Montana Zip.

The PARTY of the THIRD PART referred to herein is **JANE DOE**, **TRUSTEE OF THE JANE DOE 2012 TRUST**, (or any Successor Trustee of said Trust serving as of the death of the surviving PARTY of the FIRST PART), of Street Address, City, Montana Zip.

WHEREAS: The said PARTIES of the FIRST PART do hereby acknowledge that they are joint tenants with right of survivorship as to the below-described real property and that upon the death of either the other would be vested with sole title to the below-described real property; and

WHEREAS: The said PARTIES of the FIRST PART do wish to designate a beneficiary effective on the death of the surviving owner, the beneficiary being dependent on which of the PARTIES of the FIRST PART is the surviving owner,

WITNESSETH: The PARTIES of the FIRST PART effective on the death of the survivor of them, do hereby remise, release and quitclaim to the said PARTY of the SECOND PART if **JOHN DOE** is the survivor, or to the said PARTY of the THIRD PART if **JANE DOE** is the survivor, the following described real estate, situated in the County of Ravalli and State of Montana, to wit:

Legal Description	
Tax Parcel No:	
Recording Reference:	

SUBJECT TO all conveyances, assignments, contracts, mortgages, deeds of trust, liens, security pledges, and other encumbrances made by

the PARTIES of the FIRST PART or to which the PARTIES of the FIRST PART were subject during the lifetime of the survivor of the PARTIES of the FIRST PART.

DATED this day	y of, 20
JOHN DOE	JANE DOE
[acknowledgment]	JANE DOE

G. Common Mistakes to Avoid

If a principal purpose of using a revocable living trust is to avoid probate, then the trust needs to be funded either while the trustor is alive or the trust needs to be the designated beneficiary of assets that otherwise would be subject to probate. If the intention is to have a funded revocable trust, then the attorney make sure the client understands what needs to be done to transfer assets into the trust and offer to assist the client with that process. Real property needs to be deeded into the trust, financial accounts opened in the name of the name of the trust rather than left in the individual's name, and tangible personal property transferred to the trust by bill of sale or other appropriate means. Otherwise, it may be necessary to open a probate upon the trustor's death in order to transfer assets into the trust, and that is not what was intended. Even if all the assets are transferred into the revocable trust, client's often subsequently fail to transfer into the trust newly acquired assets. In any subsequent estate planning conferences with the client, it is useful to check as to whether they have been maintaining title to assets in proper form.

If the intention is to leave the revocable trust unfunded, probate can still be avoided for assets that can have beneficiary designations. Those beneficiary designations need to be completed while the client is alive. Assets that cannot pass by beneficiary designation should be transferred into the trust during the trustor's lifetime. The trustor should have a durable general power of attorney that allows the agent to transfer assets into the trustor's revocable trust so that if funding the trust while the trustor is alive becomes desirable, it can still be done even if the trustor no longer has testamentary capacity.