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Warding Off Living Trust Disasters: Issues to Consider when Funding your Living Trust

Since Norman Dacey published his landmark 1960s book, *Avoid Probate,* revocable living trusts have become a popular means to transfer wealth at death. The use of a revocable trust can minimize or eliminate the supervision of probate courts; increase privacy, reduce expenses and costs; and simplify the administration process at death. However, Trusts will only accomplish these purposes when assets are successfully funded into trust prior to or after death. A failure to fund can result in costly probate proceedings or worse—a transfer of your estate to the wrong beneficiaries. Rather than undermining the very purposes of the trust by failing to fund, individuals should take concrete steps in order to ensure complete trust funding.

Unfunded vs. Funded Trusts

An unfunded trust means that the trust does not hold title to assets at death. A trust may be partially or completely unfunded. Assets may be funded to a trust in several ways, including legal assignment and the re-titling of accounts to the name of the trust. For instance, a residence can be transferred to a trust by executing and recording a trust transfer deed with the county recorder. Bank accounts can be transferred to the trust by listing the name and date of the trust on title. The failure to execute trust transfer deeds, legal assignments, or change in account name forms for bank and brokerage accounts, results in a partially or wholly unfunded trust.

In order ensure proper trust funding, individuals start re-titling their assets into the trust as soon as they have executed their estate planning documents. Some assets, such as bank accounts and investment accounts, will be straightforward, and the back office of a financial institution may be available to help with the process. Other assets will require more effort and formal legal advice, including real estate, intellectual property, promissory notes, closely held business stock, and partnership interests. Check with your estate planning attorney before signing a contract for services. Some attorneys provide no funding assistance; others will help only with real estate and provide general answers to questions. Certain attorneys provide comprehensive funding services for a flat fee; still others will charge hourly for assuming responsibility for the transfer of assets. It is a poor estate planning office indeed that fails to advise clients about funding a revocable trust.

In addition to taking steps to fund the trust, individuals should also leave a document trail of proof to intent the trust. Estate plans will generally include explicit statements of intent regarding funding. In the trust itself, there may be separate schedule, called a "Schedule A", which lists the assets that individuals intend to transfer to the trust. This schedule should be

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signed, dated, and perhaps even notarized to certify the testator's intent to fund. In addition, assets should be both particularly and generally described. In other words, generic and specific descriptions of assets should be provided. There may also be separate documents, including general assignments, letters, and memoranda, which are executed in order to prove the intent to fund a trust. As discussed below, these documents may be helpful if a court procedure becomes necessary to fund a trust after death.

Assets that Remain Outside the Trust and Beneficiary Designations

Certain assets do not have to be funded to the revocable trust. For instance, retirement accounts and life insurance policies will remain outside the trust. Instead, these accounts transfer to named beneficiaries upon death.

In these cases, greater attention must be paid to the beneficiary designation than to the title. It may, in certain situations, be appropriate to name the revocable trust as beneficiary of the life insurance policy or the retirement plan. However, individuals should exercise extreme caution in naming the trust as beneficiary of such accounts because tax consequences or liability may result. For instance, most trusts do not have provisions allowing distributions from retirement accounts to be stretched out over the lifetime of trust beneficiaries. As a result, naming such a trust would result in the acceleration of distributions of the retirement plan and the incursion of income tax which could otherwise be minimized.

Naming a trust as beneficiary of a life insurance plan may also be problematic, for instance in situations where the liabilities of the trust exceed its assets. In other situations, it may be appropriate to hold the life insurance in an irrevocable trust in order to minimize estate tax.

In order to explore options for titling of these particular assets, individuals should consult with an estate planning attorney who is familiar with preparing retirement account beneficiary designations.

Options after Death for Unfunded Trusts

Often, individuals pass away without fully funding their revocable trust. In these cases, a probate is ordinarily required in California when probate assets exceed $150,000. Probate assets exclude accounts that are held in joint tenancy or that transfer by beneficiary designation, but include real property, cash accounts, or investment accounts which are held outright. If probate assets are less than $150,000, then a simple affidavit citing certain provisions of the California Probate Code may be prepared in order to compel a financial institution or other third party to

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transfer assets to the trust. A provision in the affidavit indemnifying the financial institution against any potential liability can be very effective in compelling the financial institution to transfer the asset to the named trustee.

When probate assets exceed $150,000 in value, a certain court procedure called a *Heggstad* Petition may still be possible in order to transfer assets to the trust. Under this procedure, it must be established that the decedent intended to fund his trust. Some courts require the existence of a specific assignment and particular language in the Schedule A as proof of intent. Other courts are satisfied with a generic Schedule A signed by the decedent, which lists all real, personal, tangible, and intangible property as being owned by the trust. If it may be possible to proceed with such a petition, individuals should consult with a trust administration attorney to ensure that the petition is prepared correctly. Not every county has the same rules and procedures, but a properly prepared petition will usually save the estate a significant amount of time and expense. The alternative, a full blown probate proceeding, is not an attractive proposition.

In the case where the decedent did not leave adequate proof of his or her intent to fund the trust, it will be necessary to initiate a probate. In trust based estate plans, individuals usually execute a “Pour Over Will,” which names the revocable trust as the sole heir of the estate. The purpose of the “Pour Over Will” is to ensure that assets that were not funded into the trust during lifetime will be transferred upon the conclusion of a probate. In the absence of a Pour Over will, or if the Will names other beneficiaries besides the trust, the existence of the trust may be pointless. In these cases, the beneficiaries of the unfunded assets may the decedent’s intestate heirs—for instance, one’s spouse, children, grandchildren, parents, siblings, and so on. Or, in the case of a Will which names individuals instead of the trust, those individuals would receive the estate rather than any beneficiaries named in the trust.

Conclusion: Don’t Risk Having an Unfunded Trust

As this article illustrates, the failure to properly fund a trust can seriously undermine its original purposes. While certain court procedures may be available to solve the funding problem —namely, a *Heggstad* Petition—the burden of proof for success is not always met. As a result, a failure to fund can result in costly probate proceedings or worse, a transfer of the estate to unintended beneficiaries. In order to prevent these problems, individuals should work with a qualified estate planning attorney in order to prepare effective documents and establish adequate proof of intent to fund. In general, do-it-yourself kits, mass seminars (even if presented by attorneys), and internet trusts fail to provide the resources necessary in order to satisfy the

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rigorous requirements of courts. In addition, individuals should not rely only on the documents themselves to fund the trust. Instead, each asset should actually be transferred to the trust. Very detailed oriented people may be able to do much of the trust funding themselves, particularly when a back office of a bank or financial institution is available to help. For other assets, or if you do not have the time and energy to ensure complete trust funding, make sure to consult with your attorney to determine how much funding services will be provided.

Our California Estate Planning Legal Blog is a good resource to consult if you have further questions on estate planning in general.

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