Attorney at Law

Manish C. Bhatia

Estate Planning | Wills & Trusts

Newsletter #56 • December 2014
Phone: (773) 991-8423 • **E-mail**: manish@mcb-law.com • **Web**: www.mcb-law.com

The Empty Trust

POWER POINTS

- *The end of the year presents a great opportunity to review your estate plan, your newly acquired assets and the funding of your Trust.*

- *An unfunded Trust fails to take advantage of one of the greatest benefits of a Trust…the avoidance of probate.*

- *Ongoing communication with your estate planning attorney will ensure that funding and beneficiary designations are updated.*

The end of the year is the ideal time to review your estate plan. If you do not have an estate plan in place, it is important to begin the conversation with an estate planning attorney to understand how a proper estate plan can reflect your wishes and protect your loved ones. If you have an estate plan in place, it is important to revisit your plan to ensure that it accurately reflects your wishes for your family and your financial planning needs.

A commonly neglected aspect of estate planning is the funding of the Trust.[1] When a Trust is established, assets must be transferred into it by retitling them to the trustee. While a Trust can be funded at death through a Will, doing so requires the assets to pass through the probate court. The example below explores not only the unnecessary costs and delays that can arise from failing to fund your Trust, but also the unintended consequences that can result from it.

The Consequences of an Empty Trust

Jerry has an estate plan in place, consisting of a Revocable Living Trust, a Pourover Will and Powers of Attorney for Health Care and Property. In accordance with his wishes, the Trust leaves his assets to his second wife, Elaine, in Trust for her benefit during her life, and then to George, his 10-year old child from his previous relationship. After the estate plan was executed, Jerry and Elaine's estate planning attorney provided them with written instructions on how to fund his Trust. Jerry's assets include a home which he purchased before he married Elaine, a savings account, an individual retirement account (IRA) and a life insurance policy.

Unfortunately, Jerry failed to fund his Trust prior to his death. Upon Jerry's death, any assets that Jerry owned individually without a designated beneficiary—in this case his home and his savings account—have to pass through probate court (by way of his Will) in order to reach his Trust. The probate court will validate his Will before his assets can be distributed to his beneficiaries—in this case, his Trust. This unnecessary expense and delay in accessing the assets could have been avoided by funding the Trust during his life. Although Jerry and Elaine spent the time and money to have an estate plan prepared, they did not take full advantage of their estate planning.

Incorrect Beneficiary Designations

Jerry's IRA was setup before he and Elaine were married. At the time the account was opened, he named George as the sole beneficiary. Upon Jerry's death, the account passes directly to George, to be managed by George's legal guardian (Jerry's ex-wife) under the court's supervision until George turns 18, at which time the remaining balance is paid out to him. Since there is no trustee to protect the assets, George will be able to withdraw the assets regardless of the tax consequences, if he so wishes, and do with them as he pleases.[2]

Jerry's life insurance policy was purchased while he and his ex-wife were still happily married, so she was named as the beneficiary of the policy. Upon his death, the life insurance company will pay out the proceeds to the named beneficiary. Elaine will likely contest the outdated beneficiary designation, leading to costly litigation, but since a beneficiary designation is not automatically revoked upon divorce, Jerry's ex-wife will receive the life insurance proceeds.[3]

Funding Your Trust

The only way to avoid these unexpected costs and consequences is to properly fund your Trust and designate your beneficiaries in accordance with the advice of your estate planning attorney. Not all assets can be transferred to your Trust and certain assets are best left outside of your Trust. By discussing your assets and intentions with your estate planning attorney and properly titling any newly acquired assets, you can ensure that all assets will reach your intended beneficiary without having to pass through the probate court.

---

1. For a detailed discussion of how to begin funding your trust, please see the December 2013 Newsletter: *A Guide to Organizing Your Assets*.

2. Had Jerry updated his beneficiary designation and named Elaine as the beneficiary of the retirement account, she could have rolled the account over into her own retirement account and continued to defer the income tax on the account (a benefit available only to spouses). Had Jerry named his Trust as the beneficiary, the assets would have been held for Elaine's use during her life, and then to George in Trust. By leaving the assets to George in Trust rather than outright, Jerry and his named Trustee could have protected the assets from George's creditors and his own bad decisions.

3. Please see the October 2013 Newsletter: *How to Accidentally Leave a Gift to Your Ex-Spouse*.

Manish C. Bhatia is an Illinois attorney focusing his practice in the area of Estate Planning. Manish has focused his education and practice on Tax Planning, Estate Planning and Business Succession Planning since the first year of law school. He has also added Asset Protection, Trust and Estate Administration and Nonprofit Organizations/Charitable Giving to his fields of practice. Manish has served as Vice President of Professional Development for the Indian American Bar Association and board member of the Young Professionals of Evanston.

Manish C. Bhatia | **Phone:** (773) 991-8423
1222 Chicago Ave., #305 | **Email:** manish@mcb-law.com
Evanston, IL 60202 | **Web:** www.mcb-law.com

Disclaimer

The information provided in this newsletter is provided as a courtesy and is not, nor is it intended to be, legal advice. You should consult an attorney for advice regarding your individual circumstances. I invite you to contact me and welcome your inquiries. Contacting me does not create an "attorney-client" relationship. Please do not send any confidential information to me until such time as an "attorney-client" relationship has been established.

Circular 230 Disclosure

I am required by Treasury Regulations (Circular 230) to inform the readers of this newsletter that, to the extent that the information contained herein concerns federal or state tax issues, such information was not written or intended to be used, and cannot be used, for (1) avoiding federal or state tax penalties or (2) promoting, marketing or recommending to another party any transaction or matter addressed herein.