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The Importance of Funding Your Trust

Setting up your estate plan is obviously an important first step. 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 completed that first step, it is important to revisit your plan from time to time to ensure that it accurately reflects your wishes for your family and your financial planning needs.

However, 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.

- *It is important to **revisit your estate plan** from time to time to ensure that it accurately reflects your wishes for your family and assets.*
- *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 Consequences of an Empty Trust

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

Unfortunately, Jay failed to fund his Trust prior to his death. Upon Jay's death, any assets that Jay 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 Jay and Gloria spent the time and money to have an estate plan prepared, they did not take full advantage of their estate planning.

Incorrect Beneficiary Designations

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

Jay's life insurance policy was purchased while he and DeDe 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, DeDe. Gloria will likely contest the outdated beneficiary designation, leading to costly litigation, but since a beneficiary designation is not automatically revoked upon divorce, DeDe 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.

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

2. Had Jay updated his beneficiary designation and named Gloria 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 the spouse). Had Jay named his Trust as the beneficiary, the assets would have been held for Gloria's use during her life, and then to Mitchell in Trust. By leaving the assets to Mitchell in Trust rather than outright, Jay and his named Trustee could have protected the assets from Mitchell's creditors and his own bad decisions.

3. For a related discussion, please see *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.

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