Trust Administration in Arizona

Funding the Trust

Prepared by:
Thomas J. Murphy
Murphy Law Firm

LORMAN EDUCATION SERVICES
December 2016

INTRODUCING

Lorman's New Approach to Continuing Education

ALL-ACCESS PASS

The All-Access Pass grants you UNLIMITED access to Lorman's ever-growing library of training resources:

- ☑ **Unlimited Live Webinars** - 120 live webinars added every month
- ☑ **Unlimited OnDemand and MP3 Downloads** - Over 1,500 courses available
- ☑ **Videos -** More than 700 available
- ☑ **Slide Decks -** More than 1700 available
- ☑ **White Papers**
- ☑ **Reports**
- ☑ **Articles**
- ☑ **... and much more!**

Join the thousands of other pass-holders that have already trusted us for their professional development by choosing the All-Access Pass.

Get Your All-Access Pass Today!

SAVE 20%

Learn more: **www.lorman.com/pass/?s=special20**

Use Discount Code Q7014393 and Priority Code 18536 to receive the 20% AAP discount.

*Discount cannot be combined with any other discounts.

FUNDING THE TRUST

An asset must be owned and titled in the name of the trust in order for the asset for be governed by the terms of the trust. This means each bank or brokerage account, each parcel of real estate, each beneficiary designation or any other asset must be re-titled in the name of the trust, usually along the lines of "John Jones, as Trustee of the Jones Family Trust under agreement dated August 15, 2016". This re-titling process is known as "funding the trust".

In Arizona, with the proliferation of "document preparers", the funding of trusts is often overlooked. It is either not done at all or not done correctly. This is because all document preparers that I have dealt with leave the client with the responsibility of funding the trust. This is why the price for trusts prepared by document preparers is quite minimal because undertaking efforts to fund the trust are typically more expensive than the drafting of the documents. It is a good example of "you get what you pay for".

As a result, the first step in administering a trust is to ensure it has been properly funded.

The book that is generally considered to be the leading authority on the funding of trusts is "The Funding of Living Trusts" by Carla Neeley Freitag, published by the Real Property, Probate and Trust Law section of the American Bar Association., available at http://shop.americanbar.org/ebus/store.aspx?term=freitag.

In Arizona, there is little authority as to what exactly one must do to transfer an asset into a trust. California has a line of cases beginning with Estate of Heggstad, 20 Cal Rptr 2d 433 (CA1, 1993) that concerned a revocable trust that was "self-settled", meaning it was created by Mr Heggstad to hold title to his property while he was alive. He was both trustee and beneficiary while he was alive. Mr Heggstad owned real estate but he never executed a new deed transferring the land into the name of the trust. The issue before the court was whether the land could be considered trust property.

> The court ruled that the land was trust property. It held that there was:
>
> "abundant support for our conclusion that a written declaration of trust by the owner of real property, in which he names himself trustee, is sufficient to create a trust in that property, and that the law does not require a separate deed transferring the property to the trust".

20 Cal Rptr at 436.

The only other case on point, reaching the same result, is the Kansas Supreme Court's decision in Taliaferro v. Taliaferro, 921 P2d 803 (Kansas, 1996). That case had similar facts -- a written declaration of trust but title to the grantor's assets (mainly shares of stock and a life insurance policy) was never changed. Citing Heggstad, the court ruled that:

> "where the settlor of a trust executes a declaration of trust, no transfer of legal title to the trust property is required to fund the trust".

921 P2d at 806.

Both cases rely heavily on the Restatement of Trusts, particularly section 17. After these cases were decided, a new draft of the section, now numbered as section 10, has been released. There is no significant change and the precise issue is now covered in subparagraph (c) of section 10 and comment (e), stating that "a trust may be created without a transfer of title to the property". .

These cases were cited to the Court of Appeals in a case that I was involved in, Estate of Moore, 97 P3d 103, 209 Ariz 3 (CA1, 2004), that adopted the Heggstad rationale but determined that the assets could not be considered trust property for other reasons. Note that this case was ordered depublished by the Arizona Supreme Court so its precedential value is slight but I still see this case cited in briefs at the Superior Court level.

While this approach may serve in a pinch, the better course is to execute funding instruments – deeds, assignments, beneficiary designations, etc – to avoid the issue as to whether a transfer actually took place or was intended. This can be easily done if the grantor is alive and of capacity. More often, these issues with crop up in a post-mortem setting where the funding of assets – or even locating and ascertaining them for that matter – can be considerably more difficult.

My office routinely has the client complete an omnibus assignment, a copy of which is attached to these materials. The assignment essentially states that all property is transferred to the trust. The idea is that this assignment will serve as the equivalent of a pour-over will without the probate proceeding.

But the better practice is to clearly and unequivocally transfer assets into the trust. Here are some practical tips on specific transfers:

Real estate:

For real estate in Arizona, the procedure that has now gained widespread acceptance in the use of a beneficiary deed (aka "payable on death" or "POD" deed) rather than a warranty deed. See ARS 33-405 and my article "Drafting the New Beneficiary Deed" in the June 2002 edition of *Arizona Attorney*. The beneficiary deed will not vest until the death of the last grantor to die. This means that no new deed must be issued when a client wants to refinance the home. All too often, the lender requires that the grantor deed the property out of the trust and into the names of the grantors. One would hope that the grantors would know enough to have the property deeded back to the trust after the refinancing was completed but this seldom happens. As a result, an easy and effective solution is to name the trust as the grantee on the beneficiary deed.

For a useful discussion of deeds, see my article that summarized a seminar panel of the leading real estate title lawyers in Phoenix, "Title Experts Share Insights on Deeds" in the May 2002 edition of Maricopa Lawyer, available at https://c.ymcdn.com/sites/www.maricopabar.org/resource/resmgr/ml_archives/mlmay02.pdf.

For out-of-state deeds, it is always best to employ a local law firm or title company to issue the deed. Many states have their own unique laws, rules and requirements (such as the effect of a quitclaim deed). This is particularly true with oil, gas or mineral interests. Condominiums and housing cooperatives can also create tricky titling issues. Some states, notably Florida, will take an aggressive stance against out-of-state practitioners executing deeds by claiming it is the unauthorized practice of law in that state. Or a new deed may have other local consequences, such as effecting property tax exemptions or assessments.

Mobile homes may or may not be treated as the equivalent of real estate. If a certificate of affixture has been recorded, then the property can be deeded as a parcel of real estate. Otherwise, title is passed through the Motor Vehicle Division.

Title to most boats will be kept with a state or local authority. In Arizona, the Arizona Game and Fish Department require an "Application for Certificate of Number"

to retitle the boat. If the boat exceeds 26 feet in length or five tons, it must be registered with the United States Coast Guard using an "Application For Initial Use, Exchange or Replacement of Certificate of Documentation", CG Form 1258.

Savings bonds must be retitled through the Bureau of Public Debt of the US Department of Treasury using the form PDF 1851E. Treasury bills use the form PDF 5178E.

As for marketable securities, the easiest method is having the certificates on deposit with a broker who has established a brokerage account. However, if the stock has been owned for several decades, the grantor will likely hold title in his/her own name, requiring the use of the corporate transfer agent to retitle. This information is on the certificate but is probably dated, requiring a search of the internet or similar measures. This means that the grantor must retrieve the original stock certificate and provide it to the transfer agent together with other documents, such as a letter of instruction that must have a medallion signature guarantee.

Shares of closely-held stock can also be a headache. Again, the original share certificate must be obtained. The practitioner must also determine if a shareholder agreement exists that will normally contain transfer restrictions. Almost never will the organization documents or the shareholder agreement address if transferring the shares into a grantor trust is permitted. If not, which is usually the case, then the grantor must obtain permission of the other shareholders to complete the transfer.

If the business is in the form of a Subchapter S corporation, the trust must qualify as a Qualified Subchapter S Trust, or QSST, in accordance with IRC 1361(d). These requirements essentially require that the trust have only one shareholder who is an individual and who must receive all income derived from the corporation.

Contrary to the beliefs of many insurance companies and their agents, a trust can own an annuity without jeopardizing the tax deferral of the annuity. PLR 200626034. Dealing with annuities can be tricky, with all manner of tax traps lurking out there. For an excellent, all-encompassing article on annuities, see "Evaluating Commercial Annuities" by Allan Gassman, available at http://gassmanlaw.com/wp-content/uploads/2014/11/Alan-Gassman-Final-Outline-Notre-Dame-2014-Part-2.pdf.

An interest in a 401(k) or other qualified retirement plan cannot be owned by a trust due to the anti-alienation provisions of ERISA. 29 USC 1056(d). The same result applies with IRAs. IRC 401(a)(13). Typically, the trust will be named as contingent beneficiary (after the spouse).

Often, a third party, such as a bank, will request a copy of the trust agreement. The new Arizona Trust Code essentially requires a bank or any third party to accept a "certification of trust" that summarizes portions of the trust but does not address any of the dispositive provisions. The topics that must be addressed are contained in the statute, ARS 14-11013. Often, law firms will provide a copy of the first page (indicating the trust name and who are the parties to the trust), the signature page (indicating that it was in fact created) and the section dealing with trustee's powers (indicating that the trustee has authority to do the transaction).