

Memorandum Regarding Funding and Operation of Living Trust

You are considering establishing a revocable living trust to own all or a portion of your assets. You believe this trust will achieve a number of your goals, including the desire to avoid probate procedures, the desire to avoid the necessity of a guardianship, and the desire to put your affairs in order to save family members that responsibility. In order to assist you in fully realizing the results that you intended, we want to provide you with a guide to a number of matters that will arise while funding your trust, as well as during the operation of the trust. Naturally, in this short memorandum, it will be impossible to answer all of your questions, or to anticipate all of the situations that you will encounter, however we hope to provide you with some of the information that you will need.

How to refer to the trust.

The first thing you will have to get used to is the fact that you will be acting as a separate "person" when you are acting on behalf of the trust. The correct name of your trust will be something like Jones Family Trust. You will be able to use any name that you choose for the trust.

Some frequently asked questions.

Here are a few questions that are frequently asked regarding the operation and establishment of a trust of this nature:

1. Do we have to file an income tax return for the trust? **NO.**

This trust does not have to file a separate income tax return while you are both living. You simply include all of the income from trust assets on your personal return. When the first spouse dies, however, the trust is split into two separate shares, and it is necessary to file a separate tax return for the trust holding the property of the deceased spouse.

2. Do we use a separate tax ID number for the trust? **NO.**

Under current IRS regulations, no tax ID number is assigned to trust accounts while you are living. The accounts should show your social security number (either spouse) as the tax number, even if the account is in the name of the trust. When the first spouse dies, however, the trust is split into two separate shares, and it is necessary to obtain a separate tax identification number for the trust holding the property of the deceased spouse.

3. Do we have to transfer all of our assets to the trust? **NO.**

You may transfer only a portion of your assets to the trust. It is not uncommon for people to retain assets such as automobiles, furniture and other personal belongings, as well as a "household" checking account held in joint tenancy with right of survivorship, outside the trust.

Remember, however, that any assets which are not transferred to the trust may result in the loss of the benefits that we discussed, such as avoiding probate and guardianship proceedings.

4. Do we lose our homestead exemption for ad valorem taxes? **NO.**

The trust will contain provisions to allow the homestead exemption for ad valorem tax purposes.

5. Can we have anyone else sign on the accounts? **YES.**

You can authorize someone who is not a trustee to sign on the trust accounts. Care should be taken, however, to be sure that the accounts are not characterized as joint tenants in any manner.

6. Do we have to record our trust? **NO.**

Your trust and pour-over wills do not normally need to be recorded to be effective. Most people prefer not to record these documents in order to maintain the privacy of their estate plan and property. Third parties who need to have evidence of your trust (*e.g.*, financial institutions and title companies) can normally be furnished a trust affidavit or certificate which we will furnish to you. These third parties may require that the trust affidavit be recorded. This affidavit will satisfy most third parties. A few may request a copy of the trust.

Transfer Information.

You will name yourselves as Co-Trustees (hereinafter "Trustee") of your trust. There are different questions that may arise in transferring assets to the trust. The following information will give you a general idea of how to transfer different types of assets. If you encounter difficulties, we will be available to assist you upon request.

Bank Accounts.

The trust name should appear on all accounts and certificates of deposit at banks or other financial institutions. You should make sure that none of the trust accounts are shown as joint accounts with survivorship. In addition, although you may wish to maintain a small household account in joint tenancy with some other person, you should not have any other party with survivorship rights if you want that account to be governed by the disposition in your trust.

Safe Deposit Box.

If there is a safety deposit box, you should give the box number, where it is located, and whose name or names are on the signature card to me and others who might need to know. It is not necessary to place the box itself in the name of the trust if all of the assets held in the box have been transferred to the name of the trust.

Stocks and Bonds

If stocks and bonds are to be placed in the trust, each individual stock issue and bond will need to be re-registered in the name of the trust. If the stocks and bonds are held by a stockbroker in an account in your name, it will only be necessary to change the account name so that it shows the trust as the owner. Also, please be sure to avoid making these accounts subject to a survivorship agreement.

Real Property.

It will be necessary to prepare a deed in order to transfer ownership to any real property. We will need some document, preferably the deed to the property, so as to be able to get the correct legal description. If you have real property or oil and gas properties, a complete list, together with a legal description, will be needed. If there is a mortgage, the property will be transferred subject to the mortgage. It is important to check with your mortgage company to be sure that the transfer does not violate the deed of trust and cause the mortgage to become payable in full.

If any property is located outside of the State of Texas, it will be necessary to obtain the assistance of an attorney in the state where the property is located in order to transfer that property.

Mineral Interests.

The record titleholder of your mineral interests (*e.g.*, royalty interests, working interests) needs to be changed to the name of the trust. We recommend that you assign your mineral interests into your trust, and obtain transfer orders and/or division orders from the purchasers of the production. The assignments should be filed in the counties where the properties are located and the division orders should be signed and sent to the oil companies.

Business Interests.

If you are the owner (or part owner) of a business, or a partner in a partnership, please provide relevant information such as financial statements and buy-sell agreements relating to the business. A transfer document will be necessary, and it is important to be sure that a transfer to the trust does not violate the terms of a partnership or buy-sell agreement.

Life Insurance.

You should distinguish between the **OWNERSHIP** of a life insurance policy, and the payment of the **PROCEEDS** in the event of death. If you want the policy itself, together with the cash value to be part of the trust, the policy **OWNER** must be changed. If you are only concerned about having the **PROCEEDS** paid to the trust at the time of death, this can be accomplished by a change of beneficiary form. In either case, it will be necessary to contact the company to obtain the proper form.

Casualty Insurance.

You should consult with your casualty and property insurance agent before you transfer any personal property into your Trust to make certain that:

- (1) this will not result in a business rating on your insurance policy, causing an increase in your insurance premium; and
- (2) all of your policies are amended to include and cover your trust and all of its property. Sometimes this can be done most simply and inexpensively by merely adding your Trust as an additional insured to your policy; and, for automobiles owned by your trust, listing you as an insured driver.

Retirement Plans (IRA, Keogh, 401K, Pension, Profit Sharing and Other Retirement Plans).

If there are any retirement funds or pension funds that you will be entitled to receive, or your heirs or estate will be entitled to receive, the rules are similar to the insurance policies. However, it may not be possible to change the ownership due to federal laws restricting ownership transfer on certain plans. The change of beneficiary designation may be the only (and perhaps the best) method of including these assets in the trust. This would include such things as teacher's retirement, civil service retirement, and other pension funds. It is advisable to discuss this with your C.P.A. prior to taking any action.

You should make the proper beneficiary designation for your Retirement Plans. There may be certain income tax disadvantages to naming your Trust as the primary beneficiary of your Retirement Plans. Often, the best income tax result is to have the retirement plan benefits payable to the surviving spouse, so they may be rolled over into an IRA Account and defer the income tax until the money is withdrawn by your surviving spouse. In these cases, your trust can be designated as the alternate beneficiary. If not, the plan administrator should provide you with their form to be completed by you.

The surviving spouse should consult with your CPA, financial advisor, or us, after the death of the first spouse to determine how much, if any, of these benefits to disclaim and cause to flow to your trust (instead of the surviving spouse). This will involve an evaluation of any trade offs between potential income tax and estate tax liabilities or savings.

Separate Property.

The trust contains provisions which allow the continued identification of the character of property as either community property or as the separate property of either spouse. It is still important for you to maintain appropriate records relating to assets that may be of a separate property nature. The property that one owns prior to marriage, or that property received by gift or inheritance during marriage, is separate property. In addition, contractual arrangements may affect whether property is separate or community. If either spouse is the owner of separate property, a complete list should be maintained, including information relating to the date and manner of the acquisition of such property.

How to refer to the trust.

1. During your joint lifetimes. While you are both alive, you are each granted broad powers to direct payments, and/or remove trust property, and amend or revoke the trust. Each of you is designated as a "beneficiary" of the trust, and, at any time, may receive distributions of your separate property and your share of the community property transferred into the trust.

If either of you should become disabled, the Trustee will continue to manage your trust property, and make distributions to the disabled spouse for his or her health, support, maintenance and welfare in addition to distributions to the non-disabled spouse. If you are both disabled (or one of you is deceased and the other is disabled), the Trustee would be able to continue to manage and distribute the trust assets for you.

2. Trusts with Tax Planning. If a trust includes planning for use of the estate tax exemption (the so called "A-B" or "bypass" trust), the trust will provide that at the first death, the assets will be divided

into two separate trust shares, the "Survivor Trust" and the "Decedent Trust". The Survivor Trust will be funded with the survivor's separate portion of the trust property and his or her interest in the community portion of the trust property. The Decedent Trust will be funded with the deceased spouse's interest in the trust property. However, the Decedent Trust will not be funded to exceed the "unified credit" available to the deceased spouse (presently up to \$675,000). The balance of the deceased spouse's estate, if any, will be added to the Survivor Trust.

In order to obtain the tax benefits and other advantages discussed below, the Trustee will be required to account for and allocate all trust assets, income and distributions among the Survivor Trust and the Decedent Trust. If you desire to pick and choose the assets to place in the two trusts (*e.g.*, place cash in the Survivor Trust and common stocks in the Decedent Trust), the trust gives the Trustee this option. We suggest that you and the Trustee consult with your CPA or us at that time to assist in the allocation and funding.

3. Second Death. At the second death, the assets in the Decedent Trust and the Survivor Trust will be distributed to trusts in accordance with or plan to maximize tax savings for your family.

As indicated above, this memorandum is not going to answer every question that may arise during the funding and operation of your trust. It is intended only to provide you with some general guidelines and information. Whenever you encounter a question or problem, you should contact this office to assist in the resolution.

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