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Autumn 2013 Newsletter

We are pleased to announce that Tom Stover was named Best Lawyers® 2014 Denver Trusts and Estates "Lawyer of the Year"

Only a single lawyer in each practice area and designated metropolitan area is honored as the "Lawyer of the Year."

This designation is based on particularly impressive voting averages received during the Best Lawyers® peer-review assessments. Receiving this designation reflects the high level of respect a lawyer has earned among other leading lawyers in the same communities and the same practice areas for their abilities, their professionalism, and their integrity.

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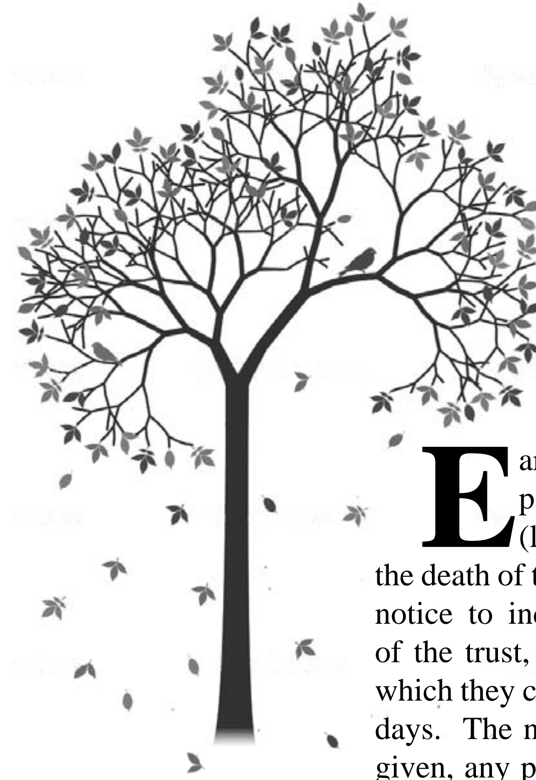

Trusts: Fund, File and Forget?
Not Quite.

Earlier this year, the Colorado legislature passed a new law applicable to revocable (living) trusts. The new law provides that at the death of the settlor [1] of the trust, the trustee can give notice to individuals who could contest the validity of the trust, and thereby limit the time period during which they can challenge the validity of the trust to 120 days. The new law also provides that if notice is not given, any person wishing to challenge the validity of the trust must do so within three years from the settlor's death. The notice must be given in compliance with the requirements of the statute.

Prior to passage of this new law, there was no mechanism for the trustee to limit the time period to challenge the validity of a trust. In contrast, Colorado law has had a system in place to limit the time period to challenge the validity of a will.

The option to give notice after the settlor's death is just one example of the steps that should be taken, or at least considered, following a death. In some cases, there is a false impression that nothing needs to be done with a revocable trust after the settlor's death, other than possibly to retitle the assets in the names of the beneficiaries. In fact, there are several steps that may need to occur including the following examples.

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1. Valuation. The decedent's assets need to be valued in order to establish their new tax basis. The decedent's assets receive a new basis, usually based on the value at date of death, which will generally result in a step up or a step down in basis.

2. Income Tax Returns. The decedent's final income tax return (Form 1040) must be filed, assuming the decedent has sufficient income to require the filing of a tax return. The decedent's final return reports income up to the date of death. If no personal representative (executor) is serving for the estate, the trustee may have the obligation to file the Form 1040. Also, a trust income tax return (Form 1041) may be required to report income after date of death.

3. Estate Tax Return. Assets of a revocable trust are not "probate assets," but they are included in the decedent's estate for estate tax purposes. If the decedent's taxable estate exceeds the available estate tax exclusion amount, then an estate tax return must be filed. The estate tax exclusion amount is $5,250,000 in 2013, but some exclusion amount may be used with lifetime gifting. In some circumstances, an estate tax return should be filed even if the estate is under the estate tax exclusion amount, such as to elect portability.[2]

[1] *Settlor*: A person who creates a trust during his or her lifetime. A settlor is sometimes also referred to as a grantor or trustor.
[2] The portability election allows the surviving spouse to use any estate tax exclusion amount not used by the first spouse.

DIVORCE
and your estate plan

Once a decree of divorce is entered, Colorado law will have a significant effect on most of your planning documents and also on many, if not all, spousal beneficiary designations and joint ownership arrangements. This article is not a comprehensive explanation of the law in this regard, but rather is only intended to make you aware of the effect of divorce on your estate planning.

The so-called Divorce Revocation Statute governs the law in this regard and provides that all "testamentary provisions" in revocable instruments in favor of a former spouse are automatically revoked. This would apply to the following:

- **Wills and Revocable Trusts:** All devises or distributions to, powers of appointments exercised in favor of, or designations of a former spouse as a fiduciary (*e.g.* personal representative or trustee), are revoked. Such provisions are treated as if the former spouse disclaimed his or her interest or died immediately before the divorce. Provisions in irrevocable trusts are not automatically revoked.

- **Powers of Attorney:** The designation of a former spouse as an agent under a power of attorney is revoked upon the earlier of a divorce or legal separation.

- **Beneficiary Designation:** A designation of a former spouse as a beneficiary under a life insurance policy or annuity contract or as a beneficiary on a "payable on death" (POD) bank or securities account will also be revoked on divorce.

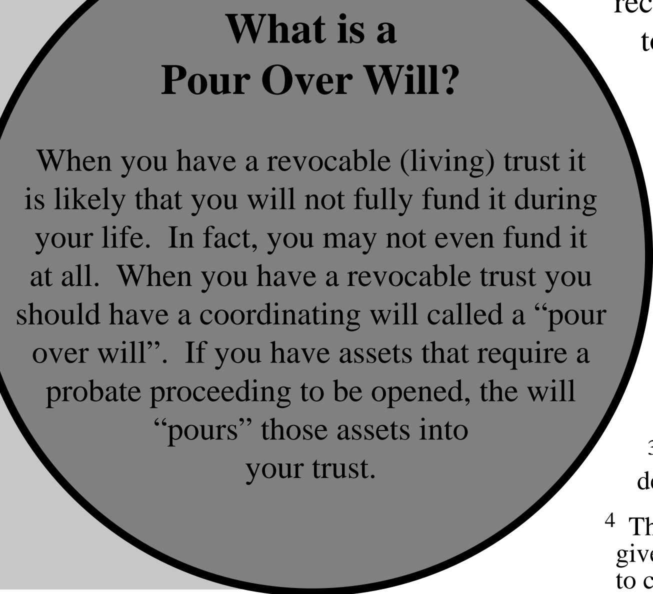
- **Retirement Plans:** The divorce revocation rules apply to individual retirement accounts (IRAs). Thus, if your former spouse was named as a beneficiary on your IRA, that designation will be revoked upon entry of a decree. However benefits under plans governed by The Employee Retirement Income Security Act of 1974 (ERISA), such as 401(k) plans, may not be subject to the divorce revocation statute. The law in this area is complicated, however, and beyond the scope of this brief overview.

Be aware that, except with regard to the revocation of the designation of a divorcing spouse in a power of attorney, if one spouse dies prior to entry of a final divorce decree, the disposition of the decedent's estate is governed by the terms of his or her most recently executed will, even if it leaves the decedent's entire estate to the spouse he or she is in the process of divorcing. Further, all or a portion of the estate of a decedent who dies intestate (*i.e.* without a will) prior to the entry of a final divorce decree will be distributed to the surviving spouse.

If a person would like his or her former spouse to be a beneficiary, agent, devisee, etc., the Divorce Revocation Statute can be overridden by the express terms of the will, trust or other "governing instrument." This may require re-executing the appropriate estate planning documents following the divorce. Also, a person can always redesignate his or her former spouse as a beneficiary of life insurance, annuities, or POD accounts in the appropriate company documents.

In many cases, it is the desire of former spouses to take each other out of their estate planning documents. The Divorce Revocation Statute provides a safety net in case the spouses fail to take each other out of all documents and off of all beneficiary designations. However, disputes can arise about the application of the statute, as occurred with a case that went before the Colorado Court of Appeals earlier this year.

Therefore, it is advisable to proactively update estate planning documents, beneficiary designations and title to property co-owned with a former spouse following a divorce. Any such changes need to be made in compliance with any requirements in the divorce decree. ♦



What is a Pour Over Will?

When you have a revocable (living) trust it is likely that you will not fully fund it during your life. In fact, you may not even fund it at all. When you have a revocable trust you should have a coordinating will called a "pour over will". If you have assets that require a probate proceeding to be opened, the will "pours" those assets into your trust.

4. Probate Assets. In many cases, a decedent with a revocable trust has not transferred all of his or her assets to the trust during life. In that situation, probate may be required for assets titled in the decedent's own name. If there is no real estate in the decedent's name, and all "probate assets" [3] total no more than $63,000 (under current Colorado law), probate assets can be transferred with a small estates affidavit, rather than by opening probate.

5. Creditor Claims. Creditor claims need to be handled carefully. In general, the decedent's creditors are not legally entitled to payment unless probate is opened and the creditors properly file their claims. A trustee who pays claims that are not legally enforceable could be liable to the trust beneficiaries. On the other hand, a trustee who distributes the trust assets too quickly, before first paying any obligations of the trust, could also face liability.[4]

A revocable trust generally becomes irrevocable and unamendable at the settlor's death, with the trust agreement providing the terms for the distribution of the trust assets.

6. Funding Subtrusts. A revocable trust may direct that subtrusts be funded at the decedent's death. These trusts may be trusts for the surviving spouse, decedent's children, or others. There are several tax and non-tax considerations with funding these trusts. For example, a new tax identification number may be needed for each trust. There may be a requirement to register the trusts with the court. If assets used to fund the trust have appreciated from the date of death to the date of funding, the gain may be recognized (causing income tax to be due).

7. Investments. A trustee is a fiduciary, and has certain fiduciary obligations imposed by the law and the trust agreement. One fiduciary duty is the prudent investment of assets. The trustee needs to evaluate the trust's assets, and may need to diversify assets and sell certain assets that are too risky for the trust to hold. The trustee cannot necessarily continue to hold the same portfolio chosen by the settlor.

8. Accountings. The trustee should inventory the assets of the trust at the settlor's death, and keep careful records of receipts and disbursements. The beneficiaries are entitled to obtain a copy of the accounting upon request, and the trust agreement may require the trustee to provide an accounting even absent a request.

9. Agreements Among Beneficiaries. There are a variety of reasons why disagreements may arise regarding a trust. There may be heirs who question the validity of the trust, especially when they are unhappy with the amount left to them under the trust. Questions may arise about the handling of the trust administration by the trustee, or regarding the interpretation of some of the trust's provisions. Before distributing the trust assets, the trustee may wish to obtain an agreement among the beneficiaries to limit the trustee's liability.

10. Handling Joint Trusts. In some cases a husband and wife may create a joint revocable trust. These are especially common in "community property" states, such as California. You should not assume that there is nothing to be done when the first spouse dies. The various requirements discussed above may apply, including the possible funding of subtrusts. It is common for a joint trust to direct that tracing must occur, with the assets contributed by the first spouse to die passing to one or more irrevocable trusts, while the surviving spouse's assets pass to a revocable survivor's trust.

This article provides some general information about the administration of a trust following a death. Each circumstance is unique. We can help you navigate the trust administration process. ♦

[3] "Probate assets" are assets held in the decedent's name and not held in joint tenancy or with a pay on death beneficiary (other than the decedent's estate), regardless of whether the estate is ultimately probated.

[4] The time period for potential creditors to bring claims can be shortened to four months from when notice is given, if a probate proceeding is opened. It can be advantageous in some cases to open probate and give notice to creditors, even if probate is not otherwise required.