

LIFECYCLE OF A REVOCABLE TRUST

BOULDER COUNTY ESTATE PLANNING COUNCIL

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I. CREATION

CRS §§15-5-401 and 402 provide for the methods for creating a trust and the requirements for creation. Typically, a revocable trust is created upon execution of the trust agreement. It is executed by the settlor and trustee, who are often the same person, but not necessarily. The trust agreement contains terms applicable during the settlor's life and at death. What follows is a description of a typical revocable trust, but trusts do vary.¹ Also, the outline covers certain highlights, but does not address all issues that arise with revocable trusts.

II. FEATURES OF A REVOCABLE TRUST

The trust may or may not be funded during the settlor's life. The settlor usually executes a pourover will directing that assets passing under the will are added ("poured over") to the trust at death, and a power of attorney that allows the agent to add assets to the trust during life. The personal representative is usually the same as the trustee (or successor trustee, if the settlor is the original trustee). In addition, the trust may be named as beneficiary of certain assets, such as life insurance policies.

To avoid any question, it is advisable to specify in the trust agreement that it is revocable by the settlor. However, even without this language the trust is presumed to be revocable and amendable by the settlor unless the trust agreement specifies it is irrevocable.²

The trust agreement is amendable by the settlor, based upon the terms in the trust agreement. For example, the trust agreement may require that all amendments must be in writing and delivered to the trustee. However, the methods specified in the trust are not the only ways to amend the trust unless the trust provides that they are the exclusive methods.³

The trust can use the settlor's social security number during life, rather than obtaining a separate tax identification. The trust income can be reported directly on the settlor's income tax return, rather than the trust filing a separate tax return.

As long as the trust is revocable by the settlor, transfers to the trust will not be completed gifts for gift tax purposes. Therefore, the settlor can transfer assets to the trust without reporting the transfers on a gift tax return. The trust assets are included in the settlor's estate for estate tax purposes.

A revocable trust serves a valuable purpose in the event the settlor becomes incapacitated. The agreement contains provisions that allow someone to serve as trustee if the settlor becomes incapacitated, and contains directions for the use of trust assets in that event. For example, the trust agreement usually authorizes distributions for the benefit of the settlor, and may allow gifts to others.

The trust agreement contains the meat of the settlor's estate plan at death. It may include directions for distribution of specific assets, cash distributions and direction for distribution of the balance (the residuary). With a thoughtful estate plan, these directions will be coordinated with the

¹ These materials do not address joint revocable trusts, although many of the points are applicable to joint trusts. These materials also do not address trusts that are irrevocable upon creation, such as irrevocable life insurance trusts (ILITs).

² CRS 15-5-602(1)

³ CRS 15-5-602(3)

will. Often the will has minimal directions, leaving these directives to instead be controlled by the trust.

III. FUNDING THE TRUST

As noted above, in some cases the trust will not be funded during life. However, there may be reasons to fund the trust during the settlor's life, such as to avoid probate. What follows are some considerations regarding certain assets:

A. Real Estate

1. Real estate is transferred to the trust by the property owner (usually the settlor) signing a deed to transfer the property to the trust. The property can be transferred directly to the name of the trust, rather than showing the name of the trustee as the grantee.⁴

2. Consider what type of deed you wish to use. If a quit claim or bargain and sale deed is used, the settlor will not be giving any warranties as to the title, but conveying with a warranty may preserve any title insurance coverage that the settlor obtained.⁵

3. Before making the transfer, consider the implications for the title insurance, property insurance and any mortgage. If the settlor obtained title insurance when the settlor obtained the property then the settlor is the insured. The trust may not be insured under the settlor's title insurance. It may be worthwhile to purchase a title insurance endorsement to extend coverage to the trust.⁶

4. If real property subject to a mortgage is transferred to the trust, will it trigger the due on sale clause in the deed of trust thereby giving the lender the right to call the loan due? Federal law and Colorado law prohibit the lender from calling the loan due in certain cases, but not in all instances.⁷

5. The settlor should advise the property insurance carrier of the change of ownership so that the policy can be updated. The same is true if vehicles are transferred to the trust. Coverage under the property/liability insurance may be compromised unless the trust is named as an insured.

6. Once the trust holds the real estate, an issue can arise with obtaining a line of credit against property held by the trust or refinancing a loan on the property.

⁴ CRS §38-30-108.5; also see Matthew L. Trinidad, *Chapter 17, §17.1.7, Real Property, Colorado Estate Planning Handbook*, Seventh Ed. (Orange Book Handbook) (David K. Johns et al. eds., CBA -CLE Books, Supp. 2019, 2020, 2022).

⁵ Eben P. Clark, "Which Deed Should I Use?," 48 *The Colorado Lawyer* 34 (January 2019).

⁶ Orange Book Handbook §17.1.14

⁷ Orange Book Handbook §17.1.13

The lender may require that the property be transferred back to the settlor in order to obtain a loan or refinance.⁸

7. Rather than transferring property to the trust, the trust could be named as beneficiary on a beneficiary deed. CRS §15-15-401 *et seq.* is Colorado's beneficiary deed statute. When a beneficiary deed is utilized, there is a concern about whether the property will be insured upon the owner's death.⁹ Therefore, it is advisable to consult with the property insurance company about adding the trust as an additional insured.

B. Bank and Investment Accounts

If bank accounts or investments are transferred to the trust, the bank or investment company may not simply change the name of the owner on the account. Instead, they may require that a new account be opened. This may be inconvenient for the settlor, who may have automatic deposits and transfers set up for existing accounts. Another reason it may be necessary to keep an account titled in the settlor's name is that certain benefits, such as pensions, may require that automatic deposits be deposited into an account titled in the settlor's name rather than the trust name. As an alternative to transferring the accounts to the trust, consider whether the planning goals can be achieved by keeping the accounts in the settlor's name and naming the trust as a beneficiary.

C. Partnerships, LLCs and Closely-Held Corporations

Before transferring a business interest to the trust, review the governing documents for the business to determine whether the transfer is permissible, or whether consent from the other owners is required. A transfer without proper consent could give the other owners the right to purchase the transferred interest, or a transfer may cause the interest to become a non-voting interest.

If you proceed with transferring business interests, a transfer of a partnership interest or LLC interest is typically accomplished by preparing an assignment. Corporations often have stock certificates, so the existing stock certificate should be submitted to the company and a new certificate issued in the name of the trust.

There are strict federal rules regarding ownership of stock in Subchapter S corporations. Under these rules, only certain trusts can hold S corporation stock. A revocable trust is a grantor trust for income tax purposes, and therefore can hold S corporation stock if the grantor is a US citizen or US resident. After the grantor's death, the trust is permitted to hold the S corporation stock for up to two years from the grantor's death without terminating the S corporation's status.¹⁰ If the stock needs to remain in trust beyond that time, consult the S corporation rules for possible elections to keep the assets in trust and maintain the S corporation status.

⁸ Orange Book Handbook §17.1.8

⁹ *Strope-Robinson vs. State Farm Fire & Casualty Co*, 429 F.Supp.3d 634 (D. Minn. 2019)

¹⁰ IRC 1361(c)(2)(A)

D. Tangible Personal Property

A bill of sale can be prepared to transfer untitled personal property to the trust, such as household items.

In order to transfer vehicles to the trust they need to be retitled with the Department of Motor Vehicles. Alternative, a trust can be named as beneficiary on a vehicle TOD designation.¹¹

IV. DURING SETTLOR'S LIFE

The trust permits distributions to the settlor, and may permit distributions to others, such as settlor's spouse and dependents. While the trust remains revocable, the duties of the trustee are owed exclusively to the settlor, unless the trust agreement provides otherwise.¹²

The revocable trust is essentially an alter ego of the settlor. As noted above, the trust uses the settlor's social security number, and transfers to the trust by the settlor are not completed gifts for gift tax purposes. The trust's income is reported on the settlor's income tax return (Form 1040). Any distribution to the settlor is a non-tax event. However, distributions from the trust to others are treated as gifts if they would have been a gift if made directly by the settlor.

Since the trust is amendable and revocable, the trust agreement may have amendments that amend certain portions of the trust, or restatements that completely restate the terms of the trust. In either case, the trust itself continues on. Therefore, assets titled in the trust should not need to be retitled upon an amendment to the trust agreement.

The revocable trust does not provide the settlor with creditor protection benefits. Settlor's creditors can reach the trust assets to the same extent they could reach assets in the settlor's name.¹³

The revocable trust is also not a planning tool to qualify the settlor for Medicaid. In fact, any assets of the trust will be countable in determining the settlor's qualification for Medicaid, even if those assets would have been exempt assets if they were titled in the settlor's own name (such as a residence with equity up to a certain amount).¹⁴

One reason the settlor might create a revocable trust is to provide a mechanism for someone else to manage the settlor's assets if the settlor becomes incapacitated. The settlor may start out as the trustee, and name a successor trustee to take over in the event settlor becomes incapacitated. A variation on this arrangement is to create the trust with the settlor and someone else as co-trustees,

¹¹ CRS § 42-6-110.5

¹² CRS §15-5-603(2)

¹³ C.R.S. §15-5-505(a)

¹⁴ Susan Fox and Daniel A. Rich., *Chapter 25, §25.5.5, Revocable Trusts, Orange Book Handbook*

so that the co-trustee is already in a position to administer the trust. With co-trustees, specify whether they must act jointly or whether they can act independently in making decisions.¹⁵

V. FOLLOWING SETTLOR'S DEATH

A. Tasks to Address Upon Settlor's Death

Death is an event that triggers several changes to the operation of the trust and imposes obligations on the trustee, including the following:

1. Tax Identification Number. Following the settlor's death, a new taxpayer identification number should be obtained for the trust from the IRS. The trust should not continue to use the settlor's social security number. For helpful information about how to complete the application to obtain a taxpayer identification number for the trust, see IRS Publication 1635.

2. Change of Trustee. If the settlor was serving as trustee then a new trustee steps in as trustee. The trust agreement should designate a successor trustee. Otherwise, CRS §15-5-704(3) provides for filling a vacancy. The successor trustee will need a death certificate, and may need to provide a copy of the trust (or portions of it) to show that the successor has stepped in as trustee. Banks and investment companies will typically require their own forms to be completed for the trustee to verify the trustee's authority, and they may require a certificate of trust (also known as a certification of trust).¹⁶ In Colorado, in order to transfer real property held by the trust, the trustee will need to record a Statement of Authority in the real property records for the relevant county.¹⁷

3. Notice Requirements. The new trustee needs to comply with notice requirements including the following:

(a) The trustee has the option to provide notice pursuant to CRS §15-5-604 which limits the time period to contest the validity of the trust to 120 days. A copy of the trust instrument must be sent with the notice. If the notice is not provided then a 3-year time period applies.¹⁸

(b) Within 60 days after accepting a trusteeship, the trustee must notify the qualified beneficiaries of the acceptance, and provide the qualified beneficiaries with the trustee's name, address and telephone number.¹⁹

(c) Within 60 days after the trustee learns that a formerly revocable trust has become irrevocable, whether by the death of the settlor or

¹⁵ If the trust agreement does not otherwise specify then CRS §15-5-703(1) provides that co-trustees who are unable to reach a unanimous decision may act by majority decision. This seems to require both co-trustees to agree when only two are serving.

¹⁶ CRS §11-105-111; CRS § 15-5-1013

¹⁷ CRS §38-30-172

¹⁸ CRS §15-5-604(1)(a)(I)

¹⁹ CRS §15-5-813(2)(b)

otherwise, the trustee shall provide notice to the qualified beneficiaries with certain information about the trust, as set forth in CRS § 15-5-813(2)(c).

B. Coordination

The trustee is often the same person as the personal representative, but not always. It is important for the trustee and the personal representative to coordinate in carrying out the required tasks after the settlor's death.

C. Collection of Assets

An important role for the trustee after the settlor's death is the collection of assets.

1. The trust may already hold assets. The trustee should inventory and secure these assets. For example, if the trust owns a house and personal property, the trustee should make sure these assets are secure, which may include changing the locks on the house.

2. If the trust is named as beneficiary of assets, then the trustee should contact the custodian to claim those assets. Be careful with retirement assets (such as IRAs and 401(k) plans) and annuities. There may be options to defer withdrawal from these assets, and therefore defer the income tax due on them, so don't be hasty in cashing them out.

3. Additional assets may be added by the decedent's will. If probate is opened, then the personal representative will handle the transfer of probate assets to the trust. If no probate is opened, then the trustee can collect the assets using a small estates affidavit if the probate assets are under the small estates limit (currently \$82,000) and do not include real estate.²⁰ Any assets that are already held by the trust or with the trust named as beneficiary are not probate assets.

D. Creditor Claims

It is important to understand how creditor claims work after death. The result is different based on whether or not probate is opened.

1. If probate is opened, then creditors of the decedent can present claims to the personal representative, or file them with the court, within the creditor claims period.²¹ The creditor claims period is a date set in the notice by publication that is at least 4 months after the first date of publication.²² However, notice to known creditors of the 4-month bar date must also be given by mail in order to effectively limit claims by known creditors to the 4-month bar date.²³ If the 4-month bar date

²⁰ CRS §15-12-1201

²¹ CRS §15-12-804

²² CRS §15-12-803(1)(a)(I); CRS §15-12-801(1)

²³ CRS §15-12-803(1)(a)(II); CRS §15-12-801(2); *Tulsa Professional Collection Services v. Pope*, 485 U.S. 478 (1988) (published notice is not an effective bar to the claims of creditors known to the personal representative; the Due Process

does not apply, there is a one-year bar date, where all claims must be presented no later than one year from the decedent's death.²⁴ If the probate estate is not sufficient to pay the claims, then the claimant can require that the personal representative recover assets from the trust in order to pay the claims.²⁵

2. If no probate is opened, then debts of the decedent are not legally required to be paid by the estate or the trust (unless the trust agreed to pay the debt). Therefore, absent probate, claims may go unpaid even though the trust has sufficient assets to pay them, such as hospital bills and credit card bills. However, creditors are not without recourse. Forty-five days after the death of the decedent, any creditor of the decedent has priority for appointment as personal representative.²⁶ Therefore, the creditor could petition to open probate and then present the creditor's claim.

3. Note that if no probate is opened then there is no way to run the 4-month bar date, so the one-year bar date will apply. This is a potential disadvantage of avoiding probate.

4. A secured creditor can recover against the secured asset regardless of whether a probate is open and a claim is presented.²⁷

5. If the trust itself incurs a debt, then the creditor is not barred by the probate claims process because the claim is against the trust rather than the estate.

E. Taxes

Various tax forms may be required and taxes due.

1. Federal Estate Tax. The assets of the trust are includable in the settlor's estate for estate tax purposes. If a personal representative is appointed, then the personal representative has the obligation to file the estate tax return. If the personal representative and trustee are not the same person, they should coordinate in order to report the trust assets on the return and determine if any estate tax is due from the revocable trust. The will and trust may direct the allocation of the payment of the estate tax. The Colorado Uniform Estate Tax Apportionment Act should also be consulted.²⁸ There are also estate tax reimbursement provisions in the Internal Revenue Code that may allow or require the executor to recover from assets passing outside of the will and trust.²⁹ If no personal representative is serving, then the

Clause of the Fourteenth Amendment requires that the creditor be given notice by mail or such other means as is certain to ensure actual notice).

²⁴ CRS §15-12-803(1)(a)(III)

²⁵ CRS §15-15-103

²⁶ CRS §15-12-203(1)(f)

²⁷ CRS §15-12-809. *See, e.g., In re Estate of Blanpied v. Robinson*, 393 P.2d 355 (Colo. 1964) (secured creditor may disregard the estate and proceed against the security).

²⁸ CRS §15-12-1401 *et seq.*

²⁹ IRC §2206 (recovery from life insurance beneficiaries); IRC §2207 (liability from property over which decedent has a power of appointment); IRC §2207A (recovery from property subject to a Qualified Terminable Interest Property [QTIP] election); IRC §2207B (recovery where decedent retained an interest in the property)

trustee is usually the “executor” in the eyes of the IRS, and has the obligation to file the estate tax return.³⁰

2. State Estate Tax. Some states also impose estate tax or inheritance tax. Colorado does not impose estate tax, but if the decedent resided in another state or owned property in another state, state estate tax or inheritance tax may apply.³¹

3. Federal Income Tax. Income up to date-of-death is reported on the decedent’s Form 1040. As with the estate tax return, if no personal representative is serving then the trustee may be responsible for filing the Form 1040.³² Income after date-of-death is reported on a fiduciary income tax return (Form 1041). An election known as the “645 election” can be made to report the trust income on the estate’s Form 1041.³³ If this is done, the trust uses the estate’s fiscal year, which may or may not be a calendar year. Otherwise, the trust uses a calendar year.

4. State Income Tax. Different states use different methods to determine whether a trust is subject to income tax in that state as a “resident trust.” Colorado taxes trusts as resident trusts if the trust is administered in Colorado.³⁴ In contrast, other states consider a trust to be a resident trust if the grantor resided in the state when the trust was created or when the grantor died.³⁵ However, even if a trust is not taxed as a “resident trust” the “source income” from that state may be taxed.³⁶ Other states impose no state income tax on trusts.³⁷ Because of these different rules, the trust may be subject to income tax in more than one state, or conversely, may escape state income tax entirely.

F. Distributions, Accountings and Notice

Prior to making distributions, the trustee should make sure the trustee has accounted for all claims, taxes and expenses that will be due from the trust. In this regard, the trustee should consider the creditor claims period, as discussed above.

Upon termination or partial termination of a trust, the trustee may provide a notice of proposed distribution, giving the beneficiaries 30 days to object to the proposed distribution.³⁸ Also, at least annually and at the termination of the trust, the trustee shall send to the distributees or permissible distributees of trust income or principal, and to all other qualified beneficiaries who request it, (I) a report of the trust property, liabilities, receipts,

³⁰ IRC §2203 (If no executor is appointed, qualified and acting within the United States, then any person in actual or constructive possession of any property of the decedent is the “executor”).

³¹ For a chart showing which states impose state estate tax see <https://www.actec.org/resources-for-wealth-planning-professionals/state-death-tax-chart/>

³² Publication 559 (If no personal representative has been appointed and if there is no surviving spouse, the person in charge of the decedent’s property must file and sign the return as “personal representative.”)

³³ IRC §645

³⁴ CRS §39-22-103

³⁵ Richard W. Nenko, “Let My Trustee Go! Planning to Minimize or Avoid State Income Taxes on Trusts,” *Heckerling Institute on Estate Planning, University of Miami School of Law* ¶1501.2, (Tina Portuondo ed., 2012).

³⁶ For example, see Colorado Dept. of Revenue FYI Income 6: Part-Year Resident and Nonresident Individuals

³⁷ Nenko, ¶1501.1

³⁸ CRS §15-5-817(1)

and disbursements, including the source and amount of the trustee's compensation; and (II) a listing of the trust assets and, if feasible, their respective market values.³⁹ This requirement may be modified in the trust agreement, but the agreement cannot eliminate the duty to respond to a request from a qualified beneficiary for the trustee's reports and other information reasonably related to the administration of the trust.⁴⁰

Various issues can arise with distributions, such as:

1. If the trust devises a certain asset to a certain person, and the asset was disposed of prior to death, does the devisee receive a substitute devise? This is an issue of ademption. CRS §15-11-606 is Colorado's non-ademption statute. It applies to wills. Although that statute does not specifically apply to trusts, CRS §15-5-112 provides that rules of construction applicable to wills also apply to trusts, as appropriate.

2. If the trust leaves a devise to a person who predeceased the settlor, does that person's descendants receive the devise? In answering that question, look at CRS §15-11-706, which is the antilapse statute applicable to trusts.

3. If the trust leaves a specific dollar amount to a certain person, is that person entitled to interest on the devise if it is not paid promptly? In the case of wills, CRS §15-12-904 requires interest at the legal rate to be paid on devises in a will if not satisfied within one year after appointment of the personal representative, unless the will provides otherwise. The legal rate is 8% per annum, compounded annually.⁴¹

Does a similar rule apply if the devise is in a trust rather than a will? Probably not. The Uniform Fiduciary Income and Principal Act would have addressed this in CRS §15-1.2-602(5). The Uniform law has the following in that subsection:

"If a beneficiary is to receive a pecuniary amount outright from a trust after an income interest ends because of an income beneficiary's death, and no payment of interest or the equivalent of interest is provided for by the terms of the trust or applicable law, the fiduciary shall pay the interest or the equivalent of interest to which the beneficiary would be entitled under applicable law if the pecuniary amount were required to be paid under a will."

However, Colorado did not enact this subsection. Subsection (5) is "reserved."

³⁹ C.R.S. §15-5-813(3)(a)

⁴⁰ C.R.S. §15-5-105(2)(i)

⁴¹ CRS §5-12-101

VI. OTHER DUTIES

There are several statutes that impose duties upon the trustee, notably:

- A. The Colorado Uniform Trust Code;⁴²
- B. The Colorado Uniform Prudent Investor Act;⁴³ and
- C. Uniform Fiduciary Income and Principal Act.⁴⁴

VII. TERMINATION

In some cases, all assets will be distributed outright to the beneficiaries after all claims and expenses are addressed, tax returns are filed, and assets are sold (if applicable). The trust essentially ceases to exist. If a Trust Registration Statement was filed, then an Amended Trust Registration Statement should be filed to show termination of the trust.⁴⁵ Note that the Colorado Uniform Trust Code made trust registration optional.⁴⁶

In other cases, irrevocable trusts are created under the trust agreement, such as for the settlor's spouse and children. The revocable trust should close (e.g. file a final tax return), but the subtrusts will continue, potentially for many years/decades. Therefore, the trust agreement continues to be relevant.

The trustee may wish to obtain receipt and releases from the beneficiaries to at least document that each beneficiary received assets distributed to the beneficiary. However, in order for a trustee to limit the time period to commence an action against the trustee for breach of trust, the trustee should comply with CRS §15-5-1005(1). That statute provides that a beneficiary may not commence an action against a trustee for breach of trust more than one year after the date that the beneficiary was sent a report that adequately disclosed the existence of a potential claim for breach of trust and informed the beneficiary of the time allowed for commencing a proceeding.

With respect to funding subtrusts, such as trusts for the settlor's spouse and children that come into effect at settlor's death, many of the considerations that apply when the settlor dies also apply when funding the subtrusts. For example:

- A. Typically, each trust will need a new tax i.d. number;
- B. Revisit whether notice needs to be sent to the qualified beneficiaries; and
- C. Consider the income tax implications for the trusts. For example, the trustee of the subtrust may not be the same as the trustee of the revocable trusts and may administer the subtrust in a different state, in which case different state income tax rules apply.

⁴² CRS §15-5-101 *et seq.*

⁴³ CRS §15-1.1-101 *et seq.*

⁴⁴ CRS §15-1.2-101 *et seq.*

⁴⁵ C.R.P.P. 8.6

⁴⁶ CRS §15-5-205

RESOURCES

Colorado Estate Planning Handbook, Seventh Ed. (Orange Book Handbook) (David K. Johns et. al. eds. CBA-CLE Books, Supp 2019, 2020 and 2022).

Eben P. Clark,” Which Deed Should I Use?,” 48 *The Colorado Lawyer* 34 (January 2019).

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