



Ag Business Management

Informing farm families and ag businesses about management issues.

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Revocable Living Trusts

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Revocable Living Trust (RLT):

The Revocable Living Trust (RLT) has some distinct advantages over a Will for use in estate planning. A traditional Will is actually a letter to the court and automatically triggers the probate process. A RLT by-passes the probate process.

Trusts established during a person's life are called living trusts. They can be revocable or irrevocable. The RLT can be amended or discontinued at any time. An Irrevocable Trust (IT) cannot be modified or discontinued once established.

Individuals who use the RLT transfer title of their property into the trust. They, as grantor, appoint themselves as the trustee (manager of the trust) and the beneficiary (receiver trust income or assets).

To establish a trust, you transfer the title of your assets into the RLT from you as an individual, to yourself as trustee of the trust. No income taxes are due on this transfer. Setting up a RLT does not constitute a gift, so there are no gift tax consequences.

Once established, everything transferred to the trust then belongs to the trust. As trustee, you maintain control. You can buy, sell, trade, or gift trust assets. If you choose to gift assets from the trust, gift them to yourself and then pass them on to the recipient. This will avoid any possible tax issues.

Positive Aspects to Using the RLT:

- RLT assets are not subject to the probate process, so your heirs may save considerable estate settlement and probate costs. You may be able to avoid attorney and court costs associated with taking inventory, distributing assets and court costs. The transfer may also

be speedier. But a relatively large part of the estate settlement cost is the filing of estate tax returns and asset transfer costs, which must be done with or without a trust. The RLT does require administration at the time of death, but this is less costly and less time consuming than the probate process.

- Having property in a RLT will avoid heirs having to disclose your holdings in the public probate process. The RLT is a private document, not open to the public.
- A RLT can continue after your death, with income and principal distributed as described in the trust instrument.
- A RLT can provide for management of assets during the grantor's declining years when they may not be able to physically or mentally manage their assets. A successor trustee is named in the trust document that can manage, invest, sell, and liquidate your assets. Select a successor trustee in whom you have confidence. Make sure your trust document stipulates any restrictions, conditions or intentions you wish to make known to the successor trustee.
- If you die owning property in more than one state and you have a Will, assets must be probated in each of those states. With a RLT, all your property is dealt with in the state of residence, subject to the RLT.
- A RLT can provide an excellent vehicle to allow a farming heir the opportunity to gradually buy into the farm business. Buy-out provisions can be written into the RLT, which allow the farming heir the right to purchase

machinery, breeding livestock or other assets over a period of years. You might also give the farming heir the right to rent the land for a number of years at a given amount of rent. In addition, the farming heir might have the right (option) to purchase the farm from the other heirs over a pre-determined time and at specified terms. A protection provision in an RLT can prevent the farming heir from having to buy-out the non-farming heirs with a lump sum purchase, which may not be doable.

Example: Sue established a RLT with a provision protecting her farming son, Sam. The trust document stated that Sam would have the option to buy Sue's machinery at her death at 10% under the appraised price. Payments could be spread out over seven years and would include a 5% interest rate. She also gave Sam the right to rent the land from the RLT for 5 years following her death at 75% of the going rate in the area. The RLT document also gave Sam the right to purchase any portion of her land at any time during this five-year period at 80% of the real estate taxable value determined at the time of death. The trust was required to finance the sale over a ten-year period with a 7.5% interest, 1-5% principal payment annually and a balloon payment in the tenth year. All rents and sales income would be distributed annually to the heirs equally over the life of the trust. Note: these reductions in purchase value may result in gift tax issues so check with a qualified attorney and accountant.

- The RLT can protect your family's inheritance from law suits and other adverse actions. Place assets into a "protective trust" within the RLT in the form of lifetime trust shares. Upon the death of both parents, the children must elect the protective trust provision and if they do so, the assets are protected from any lawsuits or other adverse actions.
- The RLT is a private document and does not trigger the probate process which can save you attorney and court costs.

Disadvantages of the Revocable Living Trust:

- You do not save federal or state estate taxes. The IRS views you as full owner of any property held in a RLT. Consequently, assets in your trust do receive stepped up tax basis at your death. Heirs can immediately sell the property if desired, with little or no tax consequence.
- The cost of setting up and maintaining the trust is immediate. Probate costs are not paid until after your death. The costs of creating a trust can range from several hundred to several thousand dollars and are paid upon

completion of the trust documents. Probate costs are generally 2-3% of the estate value.

- Trusts require management while you are alive or incapacitated.
- If not funded properly, the trust is nothing more than a pile of paper.

Critical Steps for Establishing a RLT:

The drafting of the trust document is a very important function. It should include all your wishes regarding distribution of your property. Attorney fees for setting up a RLT will generally be higher than for writing a Will. Much lower estate settlement fees and the elimination of probate fees usually offset higher initial costs.

It is important to formally transfer all assets to the trust. This is called "funding the trust" and it is critical to the process. This can be a time consuming task. Many estate attorneys will do this for you to make sure the process is complete. Most assets can be transferred into the trust without adverse tax consequences.

Form 1041, U.S. Tax Return for Estates and Trusts, has to be filed for the trust unless the grantor is both beneficiary and trustee. In that case, it is not necessary to file Form 1041 and all income and expenses are shown on the individual tax return of the grantor.

Anyone with a RLT will also need a "pour over" Will. The pour over Will transfers assets into the trust not previously transferred as well as newly acquired assets that were perhaps neglected and not placed in the trust. However, "pour over" Will assets require probate so make sure all assets are in the trust initially and newly acquired assets are funded into the trust as well.

Along with the RLT, the grantor should also have granted Common Law Power-of-Attorney as well as completing a Health Care Directive with a HIPAA authorization, guardianship designation, and a disability panel. These items will insure that the wishes of the grantor will be implemented if they are incapacitated or disabled. See your attorney.

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