

REVOCABLE LIVING TRUST

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Revocable Living Trust:

The Revocable Living Trust (RLT) has some distinct advantages over a will for use in estate planning. Though these trusts have been available for years, they are enjoying renewed popularity because they can save probate costs.

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

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

To set up a living 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 revocable living trust 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 and sell trust assets, and even give them away.

Positive Aspects to Using the Revocable Living Trust:

- 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.

- Having property in a revocable living trust will avoid heirs having to disclose your holdings in the public probate process. A living trust 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 in during the grantor's declining years when they may not be able to physically or mentally manage their property. 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. A successor trustee is usually compensated for services rendered.
- If you die and own property in more than one state, your will must be probated in each state in which you own property, requiring much more time and expense.

This will not be the case if you have an RLT.

- A revocable living trust can provide an excellent vehicle to allow a farming heir the opportunity to gradually buy into the farm business. Provisions can be written into the RLT, which allow the farming heir the right to purchase machinery, breeding stock 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 workable.

Example: Sue set up an 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 carry a 5% interest rate. She also gave Sam the right to rent the land from the RLT for 5 years following her death at a rate of \$90.00 per acre. The RLT document also gave Sam the right to purchase any portion of her land at any time during this five-year period at appraised 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.

Disadvantages of the Revocable Living Trust:

- You do not save federal estate taxes or state inheritance taxes. IRS views you as full owner of any property held in a revocable living trust. Consequently, assets in your trust **do** receive a stepped up tax basis at your death. Heirs can immediately sell the property if desired for little or no income tax gain or loss.
- 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.

- If you transfer your property to a trust, the annual Section 179 depreciation deduction cannot be used on your tax return. Instead, all capital items must be depreciated.

Setting up a Revocable Living Trust:

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 an RLT will generally be higher than for writing a will. Much lower estate settlement fees and elimination of probate fees usually offset higher initial costs.

It is important to formally transfer all assets to the trust. This can be a time consuming task. 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 individual 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 an RLT will also need a "pour over" will. The pour over will transfers any individually owned assets into the trust not previously transferred.

There is no perfect solution to every transfer or estate situation. If you decide to use an RLT, find an attorney who is well versed in drafting living trusts.

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