Distribution of Estate Assets

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Agricultural Business Management

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Basic Estate Distribution Plans:

Estate planning can be a simple or complex process depending upon the size and composition of your estate, your family situation, and your business situation. No two families have precisely the same set of circumstances. There are, however, some basic estate plans that most people follow.

No Plan:

A common plan, (not recommended), is to "not plan" for your death and your estate. No Will is written and little attention is paid to property ownership, estate distribution, or taxes. If you have no Will, state law will determine who will inherit your property. In most cases it will be divided in some manner between your spouse and children, except for joint tenancy property and life insurance. Joint tenancy property will go to the surviving joint tenant and life insurance will go to the named beneficiary. This approach will often result in unnecessary taxes and other consequences. *See Estate Planning Series #3-Establishing A Will.*

Joint Tenancy Distribution:

Another common plan is to put all property into joint tenancy and to let the surviving tenant inherit all the property. This may work well, upon the first death, with small estates where husband and wife hold all their property in joint tenancy. However, if the estate is in excess of the federal or state exclusion amount and is the second death, this approach can cause huge tax consequences.

Holding property in joint tenancy with children can cause other problems if the child dies first or if the child gets involved in bankruptcy, divorce or other adverse legal action. Many couples use joint tenancy ownership of the personal residence, personal vehicles and the checking account. When one spouse dies the survivor gets the property without delay. A joint tenancy plan can work well for families with total net estates under the federal and state Applicable Exclusion Exemption amounts. However, joint tenancy does not protect your assets from adverse actions such as law suits; it does not avoid the probate process upon the second death, and will not protect assets from long-term care costs paid for by Medicaid.

Simple or "Sweetheart" Will:

Many Wills are written which distribute all assets to the surviving spouse. Sometimes these are called "Sweetheart Wills". This can be a good plan if the total value of the couple's assets, including life insurance, is less than the Federal and State Applicable Exclusion Exemption amounts. If so, no estate taxes would be payable upon the second death. Most of these Wills leave everything to the children equally if there is no surviving spouse. A joint tenancy distribution or a simple Will, leaving everything to the spouse, gives no protection to your children. Your surviving spouse may spend or lose all the property or may remarry and lose control of your assets, leaving your children with no part of your estate. Passing the assets equally to all children may not achieve your goals of passing on your farm business to the next generation.

Complex Will:

Complex Wills are used to create a trust or structure for estate planning purposes. The complex Will category includes both AB Trust Wills and Contingent Trust Wills.

Couples who have divided their property ownership somewhat equally between themselves often use complex Wills. Upon the first death, this plan uses a Will to direct assets to the children via a trust with life use to the spouse. This is used when combined estates are valued over the federal and state Applicable Exclusion Exemption amounts and when definite provisions wish to be made for the children. Trusts created by this method are known by several titles: A-B Trusts, By-Pass Trusts, Testamentary Trusts or Credit Shelter Trusts. Any assets such as stocks, bonds, life insurance proceeds, mutual funds, real estate or cash can be set aside for the children. Willing a portion of the estate to the children, protects the children in case the spouse remarries or otherwise consumes the estate prior to death. It also prevents this portion of the estate from being taxed at the death of the spouse.

However, this process does not necessarily protect the children's inheritance from law suit or other adverse actions. Special trust provisions must be put into place to do so. It also does not avoid the probate process upon the second spouse's death. In addition, due to recent changes in Minnesota Medicaid or Medical Assistance (MA) law the value of a life estate granted **after** August 1, 2003 is subject to claim by the State of Minnesota if Medicaid/Medical Assistance payments were made on behalf of an individual.

Revocable Living Trust:

Many couples today use the Revocable Living Trust (RLT) as their primary estate planning tool. They choose a RLT because assets in an RLT pass outside the probate process, potentially saving time and money. They set up joint or separate RLT during their lifetime by placing all their assets into the trust. They designate trustees, beneficiaries and all terms of operation and distribution of trust assets. People usually designate themselves as trustees until death or incapacity when a successor or disability trustee takes over on their behalf. Trustees should be trustworthy people or institutions that can make decisions and competently comply with trust directives. Trustees should be informed of their position and made aware of your wishes.

By placing assets in lifetime trust shares within the RLT, it protects those assets from any adverse actions such as law suits, upon the death of both parents. A simple Will does not afford this protection.

A RLT also enables you to do planning in the event you become disabled or incapacitated. A Will does not allow for this provision.

Beneficiaries usually include yourself or your spouse as long as you live. You designate, in your RLT, who will get the annual income as well as the final trust distributions upon your death.

A RLT can be changed, modified, or discontinued at any time. It is flexible and adjustable. The terms of the trust should be very carefully constructed. Consideration should be given to as many contingencies as possible. Be sure to cover items such as the premature death of a child, disability of any individual, divorce of any of those involved, remarriage, protection of farm/business heirs, a buy-out provision for farm/business heirs, division of assets to farm/business and other heirs, and asset valuation changes.

Because the assets in a RLT remain as part of your estate, they receive a step-up in basis upon your death, if the step-up basis provision remains in the tax code.

When a RLT is established, a companion "pour over Will" should also be placed into effect. This will place all assets not presently in the RLT into the RLT at death, thus managing the entire estate through the RLT. The RLT also offers the advantage of privacy. A Will is a public document open to inspection by anyone, whereas an RLT is not. Assets in the RLT must also be titled in the name of the trust - called “funding the trust”. *See Estate Planning Series #5-Revocable Living Trusts.*

Irrevocable Trust:

An Irrevocable Trust (IT) is a trust established during your lifetime. One purpose is to reduce the size of your estate thus reducing taxes and/or to establish a trust for beneficiaries. It removes property, irrevocably, from your gross estate.

Placing assets into an IT is final. Assets cannot be reclaimed nor can the trust conditions be modified once established if it is a true IT.

Assets placed in an IT for the benefit of others, with no retained decision making power or right to income to the grantor, would not be included in the grantor’s estate. The assets do not receive a step-up in basis.

In MN, the assets are generally protected from Medicaid/Medical Assistance (MA) spend-down calculation and long-term care costs **IF** the IT was put into place **prior to July 1, 2005** and the grantor cannot change provisions of the IT.

In MN, an IT put into place **on or after July 1, 2005** may protect assets from the MA spend-down calculation if 60 months has passed before the individual applies for MA. See an elder law attorney for direction.

For more information, see *Estate Planning Series #4-Trusts: Definitions, Types, & Taxation.* After studying this basic educational material, contact your attorney for further information.

Summary:

Keep in mind that a typical Will does not avoid probate nor does it protect your assets from adverse actions such as law suits unless it is a Complex Will. You will need to establish a RLT to by-pass probate and to protect those assets from lawsuits. The key here is that once the trust is established it needs to be “funded” - that is, your assets need to be titled in the name of the trust.

In addition to the RLT, you will need a Health Care Directive and HIPPA authorization along with naming a disability panel including your current physician, a specialist, and family members. This directive needs to be accompanied by a Durable Common Law Power-of-Attorney.

Lastly, you will need a pour-over Will to place any new assets into the trust. Again, seek assistance from your attorney.

Caution: This publication is offered as educational information. It does not offer legal advice. If you have questions on this information, contact an attorney.