



Revocable Living Trusts

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Revocable Living Trust (RLT):

A Revocable Living Trust (RLT) can have some distinct advantages over a Will when used 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.

In a RLT, individuals transfer title of their property into the trust. This is called "funding" 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 RLT, 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 taxes. Also, you still own the assets but within the trust.

Once established, everything transferred to the RLT 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. The trust must go through an administration phase, the comparable to probate. However, this process is generally less time consuming and less expensive so your heirs may save considerable estate settlement and probate costs. The majority of 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 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 or disability trustee is named in the trust document that can manage, invest, sell, and liquidate your assets. Select a successor or disability 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 the decedent's residence, subject to their RLT.
- A RLT can provide an excellent vehicle to allow a farming heir the opportunity to gradually buy into the farm business. Purchase agreements or 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 financially possible.

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 federal and MN gift tax issues and may also affect Medicaid eligibility of the individual 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 children may encounter.
- You can name a successor or disability trustee who would assume the responsibility of your care, as stated in your trust, in the event you become disabled or incapacitated.
- 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, if tax law allows. 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 can be as much as 2-3% of the estate value.
- Trusts require management while you are alive or incapacitated.
- If titled assets are not titled in the name of the trust – "funding the trust", the trust document is nothing more than a pile of paper.

Probate costs and procedures can vary greatly by situation. Be sure to get counsel from an attorney as to the best approach for your particular situation.

Critical Steps for Establishing a RLT:

The drafting of the trust document is a very important function. It should include all your wishes regarding the management and distribution of your property. Attorney fees for setting up a RLT will generally be higher than for establishing 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 also needs 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 or "funded" into the trust. However, "pour over" Will assets require probate so make sure all assets are funded into the trust initially and newly acquired assets are funded into the trust as well.

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

A RLT can be a valuable tool but takes knowledge to complete. Trying to do a trust yourself by getting a form off the Internet or a piece of software is not recommended. Any small mistake can result in assets going where you never intended, unnecessary tax consequences, etc. See a qualified attorney for assistance.

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