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Distribution of Estate Assets

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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 and your family 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" 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. See Estate Planning Series #2 entitled *Establishing A Will*.

Joint Tenancy Distribution:

Another common plan is to put all property into joint tenancy and to let the survivor inherit all the property. This may work well in small estates where husband and wife hold all their property in joint tenancy.

Holding property in joint tenancy with children, however, can be a problem 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 and does not avoid the probate process upon the second death.

Example:

Bill and Judy, husband and wife, own a home, car and have a small savings and checking account. They place

all their property in joint tenancy. Consequently at the death of either, the property goes to the survivor, with a minimum of legal activity and outside of the probate process. However, upon the second death, the probate process may engage.

"I Love You" Will:

Many wills are written which distribute all assets to the surviving spouse. Sometimes these are called "I Love You" wills. This can be a good plan if the total value of the couple's assets, including life insurance, is under the federal Applicable Exclusion Exemption amount of \$2,000,000 (2006-08 federal). 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.

Complex Will:

Couples who have divided their property ownership somewhat equally between themselves often use complex wills. This plan uses a will to direct assets to the children via a testamentary trust with life use to the spouse. This is used when combined estates are valued over the Applicable Exclusion Exemption amount of \$2,000,000 (2006-08 federal) and when definite provisions wish to be made for the children. 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.

Example:

John and Mary each have \$1,000,000 of assets, plus a home in joint tenancy. They each decide to execute a will leaving their \$1,000,000 to the children, but with life

income (life estate) to the spouse. The surviving spouse then has his/her own \$1,000,000 estate plus income from the spouse's \$1,000,000 estate. Children are protected in that \$1,000,000 has been set aside for them, which will be available for distribution upon the death of the life tenant (surviving spouse). Since the home passes directly to the survivor, he/she has complete control of it and could sell it at any time. Either a testamentary trust or a life estate can be utilized in the will to handle the children's designated portion of the estate. See Estate Planning Series #2 entitled *Establishing A Will*.

However, this process does not protect the children's inheritance from law suit or other adverse actions. It also does not avoid the probate process upon the second spouse's death. Due to recent changes in Minnesota law, the value of life estates and remained interests granted after August 1, 2003 are subject to claim by the State of Minnesota if medical assistance payments were made.

Revocable Living Trust:

Many couples today use the Revocable Living Trust (RLT) as their primary estate plan. They choose a RLT because assets in an RLT pass outside the probate process, potentially saving thousands of dollars. They set up joint or separate revocable living trusts during their lifetime by placing all their assets into the trust. They designate trustees, beneficiaries and all terms of operation and distribution for the trust. People usually designate themselves as trustees until death or incapacity when successor trustees take over. 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 some 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 typical 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. After your death, you must designate who will get the annual income as well as the final trust distributions.

A RLT can be changed, modified, or discontinued at any time. It is completely 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 like early death of children, divorce of any of those involved, protection of farm/business heirs, an option to buy 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.

When a RLT is set up, 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 offers the advantage of privacy. A will is a public document open to inspection by anyone, whereas an RLT is not. See Estate Planning Series #6 entitled *Revocable Living Trusts*.

Irrevocable Trust:

An Irrevocable Trust (IT) is a trust established during your lifetime to save death (estate) taxes and/or to establish a trust for beneficiaries. It removes property, irrevocably, from your asset list and hence your gross estate.

Putting assets in an irrevocable trust is final. Assets cannot be reclaimed nor can the trust conditions be modified once established.

Assets placed in an irrevocable trust 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 and are protected from long-term care costs.

In Minnesota, any IT put into place after July 2005 is considered to be a RLT. If Medicaid/Medical Assistance payments were made, the state can go to the IT for reimbursement of those payment amounts.

For more information, see Estate Planning Series #5 entitled *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 protect your assets from adverse actions such as law suits. You will need to establish a RLT to protect those assets. Key here is that once the trust is established it needs to be "funded" – that is, your assets need to be placed into the trust.

In addition to the RLT, you will need a Health Care Directive and HIPPA designation along with naming a disability panel including your current physician, a specialist, and family members. This directive needs to be accompanied by a Common Law Power-of-Attorney. Lastly, you will need a pour-over will to place any new assets into the trust. Consult your attorney.

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