

G R A Y

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ESTATE PLANNING MATTERS!

Funding a Revocable Trust

Revocable trusts are a significant part of many estate plans. If a revocable trust is a component of your plan and you want to take advantage of all of its benefits, funding your trust during your lifetime is essential.

What is a Revocable Trust?

A revocable trust, sometimes referred to as a "living trust," is an agreement between a grantor¹ and trustee (often the same individual) in which the trustee holds legal title to the grantor's property and manages the property for the benefit of the grantor during the grantor's lifetime. At the grantor's death, the trustee administers the trust and distributes the remaining assets among the designated beneficiaries.

If you have a revocable trust, you can revoke that trust during your lifetime. This means that you can change, remove, or add terms to the trust, withdraw assets, and transfer additional assets to the trust. You can also terminate the trust at any time as long as you are competent.

You are treated as the owner of the trust property for tax purposes, so income and losses are reported on your individual income tax returns rather than on a separate trust tax return. When you die, your trust becomes irrevocable, and your property passes to individuals or charities named in the trust agreement rather than according to the terms of a will. Because the property is held in your trust and not in your individual name, the trustee can transfer the property to the named beneficiaries without the need for a probate proceeding. This can speed up the process of estate administration after your death.

Benefits of a Revocable Trust

If properly managed, your revocable trust has several benefits, including:

1. A revocable trust may be used to manage assets during your lifetime. If you are the sole trustee, you can manage your own assets. If you eventually need assistance because of advancing age or incapacity, your successor trustee can step in to manage the property, ensuring proper investment of assets and payment of trust expenses.
2. A revocable trust may eliminate the need for probate at your death. Probate is a court process that confirms a personal representative's authority to access a decedent's property, pay the decedent's debts and estate expenses, and transfer assets according to the decedent's will or according to state law if the decedent dies without a will. In Minnesota, if you own assets solely titled in your name² in excess of \$50,000, or real estate of any value, a probate is necessary. In addition, if you own property in another state, such as a condominium in Florida or a cabin in Wisconsin, a second probate would be required in that state. Multiple probates can add to delay in administration and additional expense after your death.
3. A revocable trust can provide more privacy than a will. In general, there is no requirement to file a trust agreement with a court or in the public records after a death. On the other hand, if a probate is required, the will is filed in the probate court of the county where you live or own property. In some cases, an inventory of assets and an accounting must also be filed. Using a revocable trust may prevent information about your assets and intentions from becoming public.

It is important to remember that using a revocable trust will not save you income taxes or estate taxes.³ Nor will it protect your assets from your creditors.⁴ A revocable trust can offer privacy, a way to plan for incapacity, and

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may reduce expense or delay in administering assets after death.

How Do I Fund My Revocable Trust?

After you sign your revocable trust agreement, the trust is ready to be funded. You fund the trust by transferring ownership of your individually owned assets to the trust, or more accurately, to the trustee of the trust. If you are the trustee, you continue to manage and use the assets in much the same way as before the trust was funded. The only difference is that title to the assets is in your name as trustee of the trust rather than in your individual name.

If you create a revocable trust, you can transfer assets to the trust as follows:

“If a trust is not funded at all before your death, or if significant assets remain titled in your name alone, a probate will be necessary. If your goal in creating a trust was to avoid probate, failing to fund the trust defeats that goal.”

Home/Cabin. You will need to sign and record a deed to transfer real property from you (and your spouse or other joint owner if applicable) to your trust. If there are mortgages on the property, you should review the mortgages before you sign the deed to make sure that the transfer does not violate any mortgage terms. If you hold your property in your trust and you want to refinance a mortgage, the trustee may need to convey the property back to you before refinancing. Because lenders have different requirements, you should let your lender know as soon as possible in the refinancing process that you own your real estate in trust.

Bank Accounts. Your bank accounts, including savings and checking accounts, can be transferred from individual or joint ownership into a new account established in the name of your revocable trust. Many people do not transfer checking accounts to their trusts because they prefer not to identify the trust on their checks. Fortunately, you can use your own name on your checks as long as your revocable trust is the record owner of the checking account.

Brokerage Accounts. Brokerage accounts can be assigned to the trust with a letter of assignment or letter of authorization. Often, brokerage firms provide forms enabling you to transfer funds from your existing account to a new account in the name of the trustee. The financial institution may request a complete copy of the trust agreement, but there is usually no reason to give a full copy of the agreement, especially if privacy is a concern. Often you can meet the brokerage’s requirement by giving a “certificate of trust,” which identifies the name and date of the trust, the acting trustees, and any provisions limiting the trustees’ powers.

Securities. Increasingly, people do not hold stock in certificate form. If you own stock evidenced by a stock certificate, you will need to work

with the stock transfer agent to register the stock in the name of the trustee of your trust. Transferring securities can be time-consuming and complicated. You can streamline the process by working with a broker to retitle the securities and by holding your securities in a trust brokerage account rather than in certificate form.

Tangible Personal Property. Untitled tangible personal property, such as furniture, collections, artwork, antiques, and jewelry can be transferred to your trust by a “bill of sale” or “assignment of tangible personal property.”

Automobile Titles and Recreational Vehicles. In Minnesota, there is no need to transfer your automobile to the trust because title registration at death is uncomplicated and should not require a probate. However, for larger vehicles, such as large boats and motor homes, you should contact the appropriate agency and complete the forms needed to title the property in the name of the trust.

Business Interests: S-Corporation, C-Corporation, Limited Liability Company, and Partnership. If you own interests in closely held businesses, you should ask your attorney to review the shareholder agreement, member control agreement, or partnership agreement to determine whether you are permitted to transfer your interest to your revocable trust. You will likely need to contact the managers of the company (for example the managing member or general partner) to find out the specific requirements for transfer.

Other Assets. You may own other assets not identified in this article. For example, you may have loaned money to a child or business entity in exchange for a note or mortgage. Or, you may own savings bonds, mutual funds, or dividend reinvestment plan accounts. If you have created a revocable trust and have not transferred those other assets to the trust, you should work with your estate planning attorney to make sure that all of your assets are transferred to your trust during your lifetime.

What Happens If You Don't Fund The Trust?

Failure to fund a trust or only partially funding a trust is all too common. If a trust is not funded at all before your death, or if significant assets remain titled in your name alone, a probate will be necessary. If your goal in creating a trust was to avoid probate, failing to fund the trust defeats that goal. Furthermore, if you become incapacitated, the opportunity for continued management of assets by a successor trustee may be lost, especially if you have not signed a durable financial power of attorney authorizing an attorney-in-fact to engage in financial transactions on your behalf. It may be that a relative or other interested party would have to petition the court to establish a conservatorship for you. This costly proceeding can be avoided by fully funding your trust.

Your estate planning attorney can assist with funding your trust by preparing deeds and other assignment documents. Ultimately you, as the grantor, are responsible for completing the funding process since only you have access and authority to retitle your assets.

If in doubt about whether your trust is properly funded, a call to your attorney is well worth your time. You can review your estate plan and work to confirm that the trust is properly funded or seek assistance in completing the funding.

¹ The grantor may also be called a settlor, trustor, or donor. We use the term "grantor" in this article to refer to the individual who creates the trust and contributes property to it.

² These are assets not held in joint tenancy and for which there is no beneficiary designation.

³ Planning for the reduction or elimination of estate taxes can be included in either a will or a revocable trust agreement.

⁴ In Minnesota, a self-settled trust revocable trust does not provide protection from the claims of creditors.

Charitable Gifts of Personal Residences

Donors who wish to benefit charity may find themselves challenged to find gifts they are comfortable making during these troubled economic times. Ideal for some donors is a charitable gift of a "remainder" in their personal residence with a reserved "life estate."

When a donor makes a gift of the remainder interest but reserves the life estate, the donor retains the right to live in the residence during his or her lifetime. The donor is responsible for paying all routine costs, including insurance, taxes, and maintenance. If the donor later wishes to move out, the donor and the charity, as co-owners, can sell the property and divide the net proceeds. The IRS prescribes the method for calculating that allocation, which is based on the donor's age and the value of the property. If the donor qualifies for the \$250,000 exclusion of gain from the sale of the home under the Internal Revenue Code, that exclusion applies to the donor's portion of the proceeds. If the property is not sold during the donor's life, it passes to the charity upon the donor's death.

An income tax deduction is available to the donor for the gift of the present value of the charity's remainder interest, based on the IRS valuation tables that take into account the value and remaining useful life of the property, the age of the donor, and the federal interest rates existing at the time of the gift. When interest rates are low, the deduction is larger. For example, a 75-year-old donor who gave the remainder in his \$300,000 residence to charity when the applicable interest rate was 5.0 percent was allowed an income tax charitable deduction of approximately \$165,000. That same gift in October of 2011—when the IRS interest rate is 1.4 percent—will yield an income tax charitable deduction of \$228,000. It is also important, however, to consider the value of the residence when deciding the best time to make the gift.

A typical donor who might find this type of gift attractive is someone who has a strong desire to benefit a charity and receive a current income tax deduction, but doesn't wish to give the residence to charity now. Instead, the donor wants to continue using the residence during his or her lifetime, but he or she doesn't have family members who want to receive the home at the donor's death.

A gift of a remainder interest in a residence is relatively simple to make; the donor executes a deed and the donor and charity usually also enter into a short gift agreement. Of course, the donor will wish to consult with his or her legal and tax advisors to understand the practical implications and tax effects the gift will have. Many donors will find that a gift of a remainder in a residence or farm is an ideal way to meet their charitable objectives.

This newsletter is a periodic publication of Gray Plant Mooty and should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only, and readers are urged to consult with an attorney concerning their own situations and any specific legal questions they may have.

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Minnesota Creates Estate Tax Exclusion for Qualified Small Business Property and Qualified Farms

An unexpected outcome of Minnesota's 2011 budget crisis was a budget bill that may help farm families and small business owners transition their businesses at death to the next generation at a lower tax cost. Before the law was passed, a Minnesota resident could pass \$1 million to non-spouse or non-charitable beneficiaries without incurring Minnesota estate tax. The new law provides an additional exclusion of up to \$4 million for a "qualified small business property" or "qualified farm property" that passes to "qualified heirs."

The new exclusion applies to estates of decedents who died after June 30, 2011, and only to estates holding property that meets certain criteria. For example, qualified small business property must be continuously owned for the three years immediately before death, and the decedent or decedent's spouse must have materially participated in the business in the year before death. For both types of qualified property, if the qualified heir disposes of the property or if a family member ceases to use the property in the operation of a trade or business within three years of the decedent's death, a recapture tax of 16 percent is imposed on the value of the property that was excluded on the estate tax return.

Individuals who own farm property or small business property should review their business succession and personal estate plans to confirm their plans take full advantage of this new Minnesota-only estate tax exclusion. For more information, please contact your Gray Plant Mooty estate planning attorney.

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