

# Estate Planning Principles

Estate Planning Series #1 5/2014

## Agricultural Business Management

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### Introduction:

Estate planning is the process of controlling your assets during your life as well as at your death. Your estate plan should focus on three objectives. Those objectives are: 1) to ensure that your assets will provide you with the necessary income and resources upon which to live, 2) to ensure that upon your death, your assets go to the people and/or organizations you intended, and 3) to minimize your estate tax, fees, and any associated court costs.

Estate planning encompasses many components. Your Will or trust must be adapted or changed to meet your goals. Property/business ownership and transition must be examined and tailored to your plan. Life insurance issues must be reviewed. Family income requirements must be matched with projected income. Other issues include treatment of heirs, power-of-attorney, health care directive with HIPAA authorized individuals, disability planning, tax planning, personal representative or trustee selection, estate administration cost savings, long-term health care issues, etc.

Estate planning is an ongoing process. As laws change and as life situations change, reviewing your estate plan is crucial.

### Who Needs an Estate Plan?

Many people feel that estate planning is for the elderly or the wealthy or is something they do not want to discuss because it focuses on death. No one knows what the future holds and so it is important that everyone have a plan.

For the young married couple with minor aged children, it is crucial to designate a guardian and conservator for those children. If both parents are killed and no provision for guardianship or conservatorship has been made, the courts will appoint the guardian and conservator. For the person who thinks they do not have enough money to worry about estate planning but have lots of life insurance, their death can create an estate tax problem. A person who is injured in an accident and suddenly is not capable of making their own medical and financial decisions, can name an individual who will make those decisions on their behalf. Bottom line is estate planning is important for everyone.

### Property Ownership:

Property in Minnesota can be held in several ways. The method chosen depends upon the individual's estate plan and how they wish their property to transfer to their heirs. Following is a list and description of the ways property can be held.

Sole Ownership is the simplest form of ownership. One person owns the property. Upon their death, the property passes via their Will through the probate process or through their trust. If they have no Will, state law dictates how assets are transferred to the designated heirs. With sole ownership, heirs receive a step up in basis on asset value upon the decedent's death, if IRS law allows.

Tenancy In Common allows two or more people to own property together. Upon the death of any tenant, the decedent's portion of the property does not go to the survivor. That property passes via the decedent's Will, through their trust or via state law. At the time of death, the value of the decedent's portion of the property is included in his/her estate. It is subject to the probate process if the decedent has a Will, not if they have a trust. The heirs receive a step up in basis on only that portion of the asset owned by the decedent. Note: if the real estate deed or abstract does not state the type of ownership, it is automatically Tenancy in Common.

Joint Tenancy is ownership between two or more people. They own the property together and upon the death of one joint tenant, the surviving joint tenant or tenants receive the decedent's property automatically regardless of what the decedent's Will or trust says. To create joint tenancy, specific wording is necessary on the ownership documents. Typical wording is "John Doe and Mary Doe, as joint tenants with rights of survivorship, not as tenants in common" for assets placed into joint tenancy established after December 31, 1976.

Upon the death of one joint tenant, his/her portion of the property is included in their estate for estate valuation purposes. Joint tenancy property is not subject to the probate process upon the first death, but may be upon the second death. This is a complex area of tax law so check with your attorney.

**Note:** The State of Minnesota may now recover

value of joint tenancy property where Medicaid (Medical Assistance) payments have been made to either joint tenant. There may be exceptions so consult with an attorney who practices in the area of elder law.

**Ownership by Contract** allows insurance contracts, investment accounts, bank accounts, and trusts to designate owners or beneficiaries upon the occurrence of a stated event such as the death of the owner. This method of ownership is not subject to the probate process and the asset is not subject to the decedent's Will or trust. The accounts are titled as Payable on Death (POA) or Transferrable on Death (TOD). With regard to deeds, there is a new provision in MN whereby a deed can be titled Transferrable on Death Deed (TODD).

**Life Estates** are another method of transferring property. A Granted Life Estate is another form of ownership. It is usually done through a Will or living trust. A person can hold title to property as a life tenant or as a remainderman. For example, if a husband passes land to his children, but with a life estate (life use) to his wife, the children are the remainderman and the wife is the life tenant. The wife receives all income from the property and must manage, maintain and pay all property expenses on it during her lifetime. Upon her death, the property passes outright to the children without being included in her estate. The property would receive a stepped up basis (valued at fair market value) on the date of the death of the husband.

A Retained Life Estate occurs when a living person gifts an asset they own to their heirs while at the same time they retain a life estate or lifetime use of the property until their death.

**Example:** A mother might gift her personal residence or farmland to her children. She reserves the right to live in the house or receive income from the farm as long as she lives. Upon her death the property passes completely to the children. It would be included in her estate and receive a stepped up basis upon her death.

**Note:** there have been changes in Minnesota law regarding life estates. If put into place **after** August 1, 2003, the assets of the life estate are subject to claim by the State of Minnesota if any Medicaid/Medical Assistance payments are involved. Creating a life estate no longer protects all assets from that process. Consult an elder law attorney for assistance with this issue.

**Probate/Non-Probate Assets:**

The probate process is established to prove that the decedent's Will is valid, to pay any debts held by the estate, to establish clear title to any assets, and to

pay any necessary income or estate taxes. Solely owned property and property owned as tenants-in-common are subject to the probate process. Joint tenancy property, life insurance not owned by the decedent going to beneficiaries other than the estate, TOD - POD - TODD, and revocable living trust property are not subject to the probate process.

The probate process can be time consuming and costly as well as making the decedent's estate information public. How property is held will dictate if the probate process applies or not.

**Note:** a Will is the equivalent of a letter to the court system and therefore triggers the probate process. This occurs if you own \$50,000 or more of assets or any real property (in MN). Having a Will does not enable you to by-pass the probate process. Establishing a Revocable Living Trust (RLT) does allow you to by-pass the probate process. If one of your goals is to avoid the probate process, you need to construct your estate plan utilizing a RLT.

**Federal Gross Estate:**

Estate taxes will be assessed on any estate that exceeds the Applicable Exclusion Exemption. This amount varies by year. The current federal amounts are listed in the following table. **Note:** State of Minnesota amounts, listed later in this document, are different than the federal amounts so plan accordingly.

With passage of the American Taxpayer Relief Act of 2013, exclusion amounts, credits, tax rates and portability were established for future years. Details are as follows:

Federal Estate Tax Exclusion		
Year	Exclusion	Credit
2011	\$5,000,000	\$1,730,800
2012	\$5,120,000	\$1,772,800
2013	\$5,250,000	\$2,045,800
2014	\$5,340,000	\$2,081,800
2015 & beyond	\$5,000,000 indexed for inflation	NA
Gift Tax Exclusion		
Year	Exclusion	Credit
2011	\$5,000,000	\$1,730,800
2012	\$5,120,000	\$1,772,800
2013	\$5,250,000	\$2,045,800
2014	\$5,340,000	\$2,081,800
2015 & beyond	\$5,000,000 indexed for inflation	NA

**NOTE:** Each person has **one** lifetime federal exclusion amount in any given year. You decide how you want to spend the exclusion amount. That is, you can use it to offset estate tax or gift tax. You do

not have two separate exclusion amounts. Assets passing through one's estate in 2013 and beyond will receive a step up in basis.

Also included in the federal tax law changes is a "portability" provision. It states that for 2013 and beyond, any unused portion of the decedent's estate exclusion can be used by the decedent's surviving spouse. This unused portion can be added to the surviving spouse's exclusion amount. To qualify, an estate tax return for the decedent must be filed even though no federal estate tax is due. Check with your attorney.

An individual's Federal Gross Estate includes all property or share in any property held at death. It will include all stocks, bonds, cash, land, machinery, livestock, life insurance policy death benefit of any life insurance policy the person **owns** regardless of who pays the premium or who is the beneficiary, as well as all other assets. The assets are valued at fair market value (FMV) as of the date of death or as of six months after the date of death if it is more advantageous for tax reasons.

#### **Deductions from Federal Gross Estate:**

Certain deductions are allowed against the decedent's gross estate. Those can include debts owed by the decedent, funeral costs, administrative costs, last medical costs, a marital deduction, and charitable contributions, etc.

##### **1) Marital Deduction**

A married person can pass any amount of estate assets to their spouse, free of any estate tax (exception: if spouse is a non-US citizen, limits apply so see your attorney). It is a deduction from the gross estate and is one of the biggest federal estate tax saving devices. The marital deduction is not available to the estates of widows, widowers or other unmarried persons. In a carefully constructed estate plan for a married couple, little or no estate tax is payable upon the first death. Each individual can pass through their estate an amount up to the Applicable Exclusion Exemption to other heirs, with the balance going to their surviving spouse using the marital deduction.

##### **2) Charitable Deductions**

The value of any property passing to qualified charities is deductible from the gross estate.

#### **Federal Estate & Gift Tax Rates:**

For taxable estates over the exclusion amount the applicable tax rate is as follows:

- 2011 - 35%
- 2012 - 35%
- 2013 & beyond - 40% maximum rate

Federal gift tax rates are the same as the federal estate tax rates. The rates are now permanent unless changed by Congress.

#### **Minnesota Estate Tax:**

Effective March 21, 2014 the MN estate tax exclusion amounts and estate tax rates were changed.

The previous MN estate tax exclusion was \$1,000,000 per person. Beginning in 2014 the exclusion increases \$200,000 per year until 2018 when the maximum exclusion per person will be \$2,000,000. In 2014 the MN estate tax exclusion will be \$1,200,000 per person.

The estate tax rates for 2014 will be a minimum of 9% for an estate value over the \$1,200,000 exclusion amount to a maximum of 16% for an estate value greater than \$10,100,000. For 2015 and beyond the estate tax rates will be a minimum of 10% for an estate value over the exclusion amount for that year to a maximum of 16% for an estate value greater than \$10,100,000. These rates are effective retroactively for estates of decedents dying after December 31, 2013.

In addition, the law change includes what is referred to as a "Q" election. For farm families who qualify for the MN \$4 million Qualified Farm Business Property Exclusion (described in next section), the "Q" election will offset the increase in the previously mentioned MN estate tax exclusion. Farm families who meet all the qualifications for the MN \$4 million business exclusion will receive the exclusion but will be limited to a total maximum MN estate tax exclusion of \$5,000,000 per person.

#### **MN Qualified Small Business Property & Qualified Farm Business Property Exclusion:**

On July 20, 2011 the Governor of Minnesota signed into law the Minnesota Qualified Small Business Property and Qualified Farm Property Exclusion. The new legislation allows for a \$4 million dollar estate exclusion for qualified small business and farm property. The property must meet all the qualifications and cannot exceed the \$4 million. This exclusion is in addition to the exclusion outlined above.

##### **Qualifications for farm property**

To qualify, the property must meet the following criteria:

- 1) The value of the property was included in the decedent's federal adjusted taxable estate, which is after deductions including

- debts, expenses and bequests to a surviving spouse.
- 2) The property consists of a farm meeting the requirements of Minnesota Statutes (M.S.), section 500.24.
  - 3) The property was classified for property tax purposes as the homestead of the decedent and/or decedent's spouse under M.S. 273.124. **If the owner has lost homestead classification prior to death, the property does not qualify for the exclusion.**
  - 4) The property was classified for property tax purposes as class 2a property under M.S. 273.13, subd. 23.
  - 5) The decedent continuously owned the property for the three-year period ending at the decedent's death.
  - 6) A family member maintains the 2a classification for the three years following the decedent's death.
  - 7) The estate and qualified heir agree to pay the recapture tax, if applicable.

**NOTE:** Currently, farm property that qualifies for the exclusion is land held as sole proprietor, land in any form of partnership, a limited liability company, S or C corporation or trust. See your attorney for information specific to your situation.

#### Qualifications for small business property

In addition to farm property, the exclusion includes small business property as well. The rules are very similar to those for qualified farm property with the exception of following issues. They are as follows:

- 1) Property consists of a trade or business property (or shares of stock or other ownership interests that are not publically traded).
- 2) Decedent or decedent's spouse materially participated in the trade or business during the taxable year that ended before the decedent's death.
- 3) Trade or business had gross annual sales of \$10 million or less during the last taxable year that ended before the decedent's death.
- 4) The property does not consist of cash or cash equivalents.
- 5) A family member materially participates in the operation of the trade or business for the three years following the decedent's death.

#### Qualified family member/heir

- 1) The decedent's ancestors (parent, grandparent, etc.);
- 2) The decedent's spouse;

- 3) A lineal descendent (child, grandchild, etc.) of the decedent, of the decedent's spouse or of the decedent's parents; or
- 4) The spouse of any lineal descendent described above.

#### Recapture tax

If any of the following occur within three years of the decedent's death and before the death of the qualified heir, then a recapture tax is imposed:

- 1) The qualified heir disposes of any interest in the qualified property (other than by a disposition to a family member),
- 2) For the qualified farm property deduction, a family member does not maintain the 2a classification for the qualified property,
- 3) For the qualified small business property deduction, a family member does not materially participate in the operation of the trade or business.

The recapture tax equals 16 percent of the amount of the exclusion and must be paid to the Minnesota Department of Revenue within six months after the date of the disqualifying disposition or cessation of use.

To claim the exclusion, complete and submit Schedule M706Q, *Election to Claim the Qualified Small Business and Farm Property Exclusion* when filing the decedent's Minnesota estate tax return.

#### Information Returns:

When an estate elects for this deduction, a qualified heir must file two informational returns to confirm that no recapture tax is due. The first return is due 24 - 26 months after the decedent's death. The second return is due 36 - 39 months after the decedent's death. This requirement is effective for returns due after December 31, 2013 (that is, for estates of those who died after Dec. 31, 2011).

#### Additional Estate Tax Rules:

MN estate tax law allows for the taxation of a non-resident's estate where the non-resident has ownership interest in MN property held in a pass-through entity that owns real estate or tangible personal property (machinery, livestock, crop inventory, etc.).

Pass-through entities are defined as S corporations, partnerships, single-member LLCs and trusts. This does not include publically traded entities.

The new law is effective for the estates of decedents dying after Dec. 31, 2012.

### **Minnesota Gift Tax:**

Effective March 21, 2014 the MN gift tax law was repealed to the effective date of July 1, 2013.

The only provision in the gift tax law that was kept intact was the 3 year add-back of gifted assets. The value of gifts in excess of the federal annual gift exclusion amount of \$14,000 for 2014 (recorded on the IRS 709 form) made within 3 years of the decedent's death will be added back into the decedent's estate to determine if MN estate tax is due.

### **Special Use Valuation (SUV):**

Closely held real property (farm land or small business property) can be valued not at FMV, but at a Special Use Valuation (SUV) if the estate meets several complex qualifications. SUV usually results in a lower valuation than FMV and may possibly reduce an estate tax obligation.

SUV is calculated using the 5 year average land rental rate for comparable land minus the real estate taxes paid, divided by the AgriBank FCB 5 year average annual effective interest rate for the state where the decedent lived (rate changes periodically so see your attorney or accountant).

**Example:** Land is appraised at \$5,200 (FMV) per acre with real estate taxes of \$26 per acre, average cash rent of \$200 per acre, and the FCB average effective interest rate of 5.93 percent (MN). The SUV calculation is as follows:

$$\frac{\$200 \text{ rent} - \$26 \text{ RE tax}}{.0593 \text{ FCS interest}} = \frac{\$174}{.0593} = \$2,934/\text{acre SUV}$$

Using the SUV on this land could save estate taxes on the value of \$2,266/acre (Note: there are limits on the total dollar amount of reduction - see your attorney or accountant).

#### **Note:**

- 1)** SUV should not be used on estates that are less than the Applicable Exclusion Exemption for the year in question. Doing so may result in a lower than necessary tax basis as well as unwanted rental and sale restrictions.
- 2)** The business must be in compliance with the SUV rules for 10 years or you lose the SUV designation. The recipient must farm the land for 10 years - that means materially participating by farming the land or farming on shares and having financial risk. The person cannot rent the land to someone else for cash - that violates the SUV conditions.
- 3)** To qualify the decedent's estate must have included at least 50% ag assets and at least 25% farm land.

- 4)** With people living longer, this is usually not a viable alternative.

### **Power-of-Attorney (POA):**

An individual (grantor) can grant another individual Power-of-Attorney in the event they are incapable of making decisions due to disability or incapacity. The individual or individuals can manage your assets on your behalf.

### **Power-of-Attorney categories:**

**1) Common Law Power of Attorney** powers are specifically listed by the grantor. There are no gifting limits. Can be either general or springing (begin at a specified time). Grantor authorizes powers to be effective immediately or upon disability. Granted powers remain in effect throughout grantor's life or incapacity.

**2) Statutory Short Form Power of Attorney** powers are governed by state law and are generally very broad. Powers can be changed at any time by legislative law change. Powers typically take effect immediately and there is a \$10,000 gifting limit per person in MN. In MN, after June 1, 2104 all former statutory short forms become common law trusts and you cannot enforce the statutory rights and the form can be changed. In addition, a new ruling allows any government agency to require an accounting of the "attorney in fact" (person who is power-of-attorney) for anything they are doing financially on behalf of someone else.

**3) Durable Power-of-Attorney** Both Common Law and Statutory Powers-of-Attorney can be durable. Durable means the powers will continue to be affective after disability. If an individual does not have the durable form of POA and becomes incapacitated or disabled, the courts will appoint a new POA.

Sometimes a POA alone is not accepted by banks, health care facilities, etc. Generally the reasons are the document is too old, too new, too long, too short, has in it the wrong wordage or missing a required phrase, etc. The solution to this issue is to: 1) name the same person as your trustee, POA, guardian, and conservator. Use a Common Law Durable POA in conjunction with your Revocable Living Trust to avoid guardianship and conservatorship. Include in the package your Health Care Directive and HIPAA authorization.

### **Health Care Directive:**

A Health Care Directive allows one to decide what level of health care you want if you become disabled or death is eminent. You can list whether or not you

want to be kept alive or not. You can list if you want to be an organ donor. You can outline your funeral in the document as well. It is a binding contract document that family members and health providers must follow.

### **HIPAA Designations:**

In 1996 the federal Health Insurance Portability & Accountability Act (HIPAA) was passed. It requires you to list individuals you grant access to your medical records. If an individual is in the hospital and cannot speak for themselves or give permission for someone to have access to their medical records, the health care facility legally cannot release your health care information, not even to your spouse or children. This applies to adults as well as to any person 18 years of age or older.

Attorneys will sometimes place the HIPAA documents within the health care directives. Others will make it a separate document. While others will include it as a separate document and include it in the health care directive as well. Whichever way it is done, this is a key document for your personal estate plan.

### **Disability panel:**

A disability panel can assist in determining if you are disabled and no longer able to make decisions on your own behalf. The panel may include your current physician, a specialist, and family members. Many hospitals and health care providers have information on developing the care directive as well as forms to complete.

### **Summary:**

To by-pass the probate process and to have your needs taken care of in the event you become disabled or incapacitated, you need to establish a RLT, Durable Common Law Power-of-Attorney, a Health Care Directive, a disability panel, HIPAA authorization, guardianship designation and a pour-over Will. Lifetime trust shares held in a protected trust within the RLT can protect some assets from lawsuit and other adverse actions.

If one spouse places assets in the RLT within the protected trust as lifetime trusts shares, upon their death those assets are protected and held for the remaining spouse's health, education, and maintenance. Parents can use the same process for assets passing to their children. Assets passed in this manner to an individual on Medicaid, will not make them ineligible for those benefits.

For legal advice in this area, see an attorney that practices in the area of elder law.

For more details see the following information sheets in this series:

*Estate Planning Series #3-Establishing a Will*  
*Estate Planning Series #5-Revocable Living Trusts.*  
*Estate Planning Series #12-Maintaining Farm Land Homestead Classification and Qualification for Minnesota \$4 Million Qualified Small Business Property Farm Property Exclusion.*

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

# Distribution of Estate Assets

Estate Planning Series #2 5/2014

## 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 thousands of dollars. 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.

# Establishing A Will

Estate Planning Series #3 5/2014

## Agricultural Business Management

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### What Is A Will?

A Will is a legal document which lists instructions regarding the distribution and management of your assets. A Will technically directs finances only, with the exception of guardianship. A Will is usually a first step in the estate planning process. However, because of the extra expense and complication of the eventual probate process, the emerging practice is to avoid using the Will as the primary tool for estate planning.

If you are of legal age and of sound mind, you can draft your own Will. However, a Will drafted by an attorney is much more likely to encompass all the estate law provisions, insuring a legal description of your wishes. The same applies to a Will document from the Internet or a software package. The expense of having an attorney draft your Will is minimal compared to the potential tax liability or assets going where you did not intend them to go, if you make an error developing the Will on your own.

A husband and wife should each have a separate Will. A Will can be personalized and great latitude can be taken in how your individual Will is written. Consult with an attorney regarding this issue.

### What Happens If You Have No Will At Death?

Each state generally has a succession law that dictates how assets are distributed if a person dies without a Will, referred to as dying "intestate". In Minnesota, property held in joint tenancy goes to the surviving joint tenant. Life insurance proceeds go to the designated beneficiaries. Any remaining property is distributed according to state law. The spouse and children or next of kin are allocated a portion of the estate based on their relationship, number of survivors and the composition of the estate. If there are multiple marriages involved, the state's plan becomes very complicated.

The issue with the state plan is that it is complex and is not at all flexible. It does not change as your family and financial situation changes. The state plan may provide inadequate income for the surviving spouse.

The state plan may unfairly treat a farming or business heir if assets are equally divided between all heirs. The state plan also allows a judge to

designate a guardian and conservator for minor children and caretakers for your property. The only way to prevent these issues is to establish a Will of your own and not rely on the state's intestate law.

Check with your attorney to determine how Minnesota intestate laws would impact your situation.

### Typical Articles in a Will:

A Will typically contains various articles or sections that outline your wishes regarding a given issue.

Most contain a provision naming a guardian and conservator for minor children. The guardian oversees the day-to-day physical care of the minor children. The conservator manages and financial decisions on behalf of the minor children. The individuals you select for guardian and conservator should be consulted in advance and asked if they would be willing to care for your children in the event of your death. You can name separate individuals for their care and financial matters. This is a must for young couples with minor children.

Another article names a personal representative to manage and handle the administration of your estate and your Will. Most often a spouse or family member is named to this position. However, anyone may be named. The person or persons named should be someone you trust to handle your affairs fairly and in a business-like manner. The individual or individuals should be consulted in advance. Personal representatives can charge a fee for their services.

Most Wills have several articles which establish procedures for the distribution of property. These articles should take into account contingencies such as what if the spouse dies first, both spouses die together or the entire family dies. Similarly, the Will should address what happens if a married child dies or is divorced before your death. You can also insert "bloodline" protection in the event the surviving spouse remarries. This can prevent assets from leaving the family lineage.

Your Will requires signatures and must be notarized. Most Wills give special mention of the spouse. You cannot completely disinherit a spouse unless a valid prenuptial agreement has been previously executed or the spouse signs documents agreeing not to accept the inheritance.

Some Wills provide special provisions regarding special family needs. Sometimes, impaired family members are given special attention or bequests. Friends and charities are also mentioned specifically in the Will. Often, farming or business heirs are given special privileges regarding the purchase of the business assets. They may receive a “first right of refusal” or special terms in the form of a buy-out provision or purchase agreement enabling them to pay off the non-heirs who have an ownership interest in the business. Sometimes, certain heirs are given an “amount off the top” to compensate for past inequities or previous gifts.

### Types of Wills:

Simple or “Sweetheart” Will direct everything to the surviving spouse or to children if no spouse survives. For younger people, with small and relatively simple estates, the simple Will can be quite satisfactory. A critical aspect of the Will for the younger family is the naming of guardians and conservators if they have minor children. As families and finances grow and there is a need to protect the children further, a more complex Will or Revocable Living Trust may be required.

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. Due to recent changes in Minnesota Medicaid/Medical Assistance (MA) law, the value of life estates granted **after** August 1, 2003 are subject to claim by the State of Minnesota if Medicaid/Medical Assistance payments were made on behalf of an individual.

### After You Have Written Your Will:

Keep it in a safe place - your safe or a safe deposit box. There is only one original so you need to keep that in a very safe place. Don’t forget to review your Will periodically. It is best to review it frequently, but particularly if any of these events have taken place:

- marriage/remarriage
- birth of children
- estate growth
- divorce
- move to another state
- death of spouse or child
- inherit property
- estate law changes
- health status changes
- children’s status changes

If you wish to change your Will slightly, you may use what is called a codicil (addendum) to make changes in the Will. If you wish to direct certain personal items to certain friends or relatives, a letter of instruction can be drafted and included with your Will. It is referred to in your Will and allows you to direct certain household or family items to whomever you wish. Consider making multiple copies of this document and share them with your children. By sharing your Will and your reasons for what you did with your assets, family discord may be avoided.

### Summary:

A Will is the equivalent of a letter to the judge and court system which automatically starts the probate process. Probate can be costly, time consuming, and is a public process. A Will does not protect your family’s inheritance from adverse actions such as law suits unless you establish a “protected trust” within a Complex Will.

In order for you to protect your assets, avoid the probate process, and have your wishes implemented in the event you become disabled or incapacitated, you will need to do the following:

- 1-** Establish a Revocable Living Trust with “lifetime trust shares” to protect some assets from any adverse actions, **making sure the trust is funded** (assets with a title are titled in the name of the trust) once established,
- 2-** Develop a Health Care Directive including the listing of a disability panel consisting of your current physician, a specialist, and family members. HIPAA authorization, guardian and conservator designations can be included or placed in a separate document, and a Durable Common Law Power-of-Attorney, and
- 3-** Establish a pour-over Will to place any new assets into the trust if you forget to do so.

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

# Trusts: Definitions, Types & Taxation

## Agricultural Business Management

Gary A. Hachfeld, David B. Bau, & C. Robert Holcomb, Extension Educators

### What Is A Trust?

A trust can provide a means to hold and manage your property. Think of a trust as a bucket into which you place all of your assets. It can be custom designed for your situation.

A trust has basically four elements: (1) a trustee, (2) trust property, (3) beneficiaries and (4) instructions and guidelines.

Any type of property such as cash, personal property or real estate, business entity ownership shares, etc. can be placed in a trust. Transferring assets to a trust is a formal process and titled assets must be changed from individual ownership to trust ownership. This is referred to as “funding the trust” and is a critical part of the process.

As grantor of the trust, you name yourself as trustee and beneficiary of the trust. As trustee, you hold and manage the property in the trust in accordance with the instructions, rules and guidelines you write into the trust instrument. In your trust, you can name a successor or disability trustee who would take over your trust management in the event you become disabled or incapacitated. This trustee can be an individual or an institution such as a bank trust department. This trustee should be someone you trust to serve in that capacity and should be astute in business matters and have high ethics.

The beneficiaries are the people for whom the property is managed. They can receive annual earnings distributions and eventually will receive the entire trust principal (“corpus”) when the trust is terminated.

The trust instrument is an important document. Its creation and content should be carefully thought out. Consider all contingencies that could arise regarding you or the beneficiaries, and plan accordingly. The trust instrument is a complete set of guidelines for the operation of the trust. A person can be very flexible in the design of his/her trust. The trust instrument may specify the powers, responsibilities, and latitude of the trustee. The trust instrument also directs paying out of trust income to beneficiaries, lists instructions as to timing of final distribution, and trust termination. Extreme care should be taken to design the trust so that it accomplishes the

objectives and goals of the individual (grantor) establishing the trust.

Trusts are used for many purposes including the management of assets for minors, elderly persons, or handicapped persons, as well as protecting assets from law suits and other adverse actions. Trusts are also used to manage property for a surviving spouse who prefers to have someone else (trustee) manage the assets. A trust may also be used to leave someone a limited interest in property or to transfer a farm business. Trusts can also be established to reduce the size of an estate or to minimize estate and probate costs.

### Types of Trusts:

There are several different types of trusts. However, there are two main types of trusts: living trusts and testamentary trusts.

Living trusts are established during the grantor's lifetime and may continue after death. A living trust can be either a Revocable Living Trust (changeable) or an Irrevocable Trust (unchangeable). Living trusts are often set up to avoid probate costs at death, since living trust assets do not need to be probated. Unlike a Will, living trust assets are not subject to public disclosure during and after the trust “administrative” process. A living trust can be useful in providing management through a trustee for older family members as they advance in age or for anyone who may be disabled or incapacitated.

Individuals who use the Revocable Living Trust (RLT), 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 and/or assets). To set up a living trust, they transfer the title of their assets into the trust from themselves as an individual, to themselves as trustee of the trust. No income taxes are due on this transfer. In addition, the assets in the trust are still under your control and remain as part of your estate. Therefore, the trust assets receive a stepped up tax basis upon your death, if that provision remains in the tax law. Placing assets into a “protective trust” in the form of “lifetime trust shares” within the RLT can protect those assets from lawsuits and other adverse actions when the assets pass to the heirs.

Upon the death of the trust grantor, the RLT becomes an irrevocable trust and requires its own IRS tax ID number. See *Estate Planning Series #5- Revocable Living Trusts*.

An Irrevocable Trust (IT) is designed mainly to save estate taxes. The grantor is neither the trustee nor beneficiary and therefore has no control over the trust assets or their ultimate disposition. The trust assets will not be included in the grantor's estate and therefore do not receive a stepped up tax basis. Irrevocable trusts may also reduce probate costs since assets put into the trust are treated as a gift and are removed from the estate of the grantor. Creating an IT may have gift tax ramifications if the gift exceeds the annually exclusion amounts. All rules regarding the IT must be followed. Any access by the grantor to the assets in the trust violates the rules and the trust is no longer irrevocable. However, the grantor of the trust can receive income from the trust and not violate the IT rules. An example would be land rent from land in the IT as long as the grantor could not change the provisions of the trust.

In MN, any IT put into place **on or after July 1, 2005** can protect the IT assets from the Medicaid/Medical Assistance (MA) spend-down calculation **IF** 60 months has passed before the individual applies for MA. Check with a qualified attorney to insure that the document you draft is a true IT. If you have MA questions check with an attorney who practices elder law for details specific to your situation.

Various trust titles established within the Complex Will include the following: A-B Trusts, By-Pass Trusts, Testamentary Trusts or Credit Shelter Trusts. They become effective at first death. These trusts do not save probate fees because upon the first death, the Will directs the estate to probate and this then establishes the trust. The main purpose of a trust like this is to reduce estate taxes and preserve income for the surviving spouse. This process can keep asset amounts below the Applicable Exclusion amounts, thus reducing or eliminating estate taxes. A "protected trust" can be established within the testamentary trust to protect assets from lawsuits and other adverse actions once those assets pass to the heirs.

A Charitable Remainder Trust (CRT) can be established to transfer assets to a charity while retaining an income stream during your lifetime and your spouse's lifetime. It acts much like an annuity. Upon the death of the surviving spouse, or the end of the life of the trust, the property passes to the charity. The value of the remainder interest is deductible for income tax purposes in the year of the gift.

There are several other trusts that may be useful in estate planning. The irrevocable life insurance trust, the generation skipping trust, and others may offer possibilities for estate planning. Before choosing any trust, thoroughly investigate its ramifications and seek good legal counsel when drafting your trust.

### **Taxation of Trusts:**

Simple trusts are required to distribute all of their income to the beneficiaries. The beneficiaries generally pay the income tax on their share of trust income. Complex trusts may themselves pay taxes on undistributed income. This income is reported on Form 1041, U.S. Income Tax Return for Estates and Trusts.

### **2013 federal tax rates are:**

<u>Income</u>	<u>Tax</u>
\$0 - 2,450	15% of taxable income
\$2,450 - 5,700	\$367.50 plus 25% over \$2,450
\$5,700 - 8,750	\$1,180 plus 28% over \$5,700
\$8,750 - 11,950	\$2,034 plus 33% over \$8,750
Over \$11,950	\$3,090 plus 39.6% over \$11,950

### **2014 federal tax rates are:**

<u>Income</u>	<u>Tax</u>
\$0 - 2,500	15% of taxable income
\$2,500 - 5,800	\$375 plus 25% over \$2,500
\$5,800 - 8,900	\$1,200 plus 28% over \$5,800
\$8,900 - 12,150	\$2,068 plus 33% over \$8,900
Over \$12,150	\$3,140 plus 39.6% over \$12,150

Most trusts distribute all income to avoid the high taxation rates. However, if all income from a RLT goes to the grantor, and if the grantor is also the trustee, no additional income tax forms are required. All income from the RLT is shown on the grantor's income tax return. If the grantor is not the trustee and beneficiary, the trust must file Form 1041, and obtain an Employer Identification Number for the trust. Check with your accountant or attorney for direction.

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# Revocable Living Trusts

Estate Planning Series #5 5/2014

## Agricultural Business Management

Gary A. Hachfeld, David B. Bau, & C. Robert Holcomb, Extension Educators

### 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 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.

#### **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.

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# Gifts Assets

Estate Planning Series #6 5/2014

## Agricultural Business Management

Gary A. Hachfeld, David B. Bau, & C. Robert Holcomb, Extension Educators

### Introduction:

Gifts to others can be a valuable tool in estate planning. Gifts can help you reduce your taxable estate. In some states, gifts might help you make a small estate smaller and thus avoid the probate process. Gifts can also transfer tax obligations to your children who may be in a lesser tax bracket, provide for a favorite charity, or provide help to others. By giving assets away before you die, you get to see the recipient enjoy your generosity.

Use caution however. You want to be sure that gifts are made only from excess assets. You do not want to impoverish yourself or your spouse. In addition, gifts made while you are alive, beyond a certain size, are subject to gift taxes.

### Federal Gift Tax:

Virtually anything you own can be gifted to others. The IRS allows you to give away a certain amount of property without any gift tax or gift tax reporting. Currently, each person can gift up to \$14,000 per year (Annual Gift Exclusion) to as many people as they wish, free of any gift tax. In addition, the individual is not required to file the IRS 709 Gift Tax Form. A couple can gift up to \$28,000 per donee per year, if they write two separate checks for \$14,000 each or they file an IRS 709 form. This strategy can be used to reduce a person's estate to a level below the federal and perhaps the state exclusion amount, thus avoiding estate tax.

Federal estate & gift tax law has established the lifetime exclusion amount at \$5,000,000 and indexed it for inflation. For 2013, every person has a federal Lifetime Gift Exclusion that will offset gifts of up to \$5,250,000. For 2014 and beyond this amount is \$5,000,000 and indexed for inflation so it will change each year.

**NOTE:** Each person has **one** federal lifetime exclusion amount in any given year. You decide how you want to spend the exclusion amount. That is, you can use it to offset estate tax or gift tax. You do not have two separate exclusion amounts.

Federally, gifts given in excess of the annual exclusion (\$14,000 per individual, \$28,000 per couple) reduce the individual's lifetime exempted amount. See *Estate Planning Series #1-Estate Planning Principles*. The following example illustrates this.

**Example:** Susan gave \$54,000 to her son Caleb. After subtracting the \$14,000 annual exclusion, a possible taxable gift of \$40,000 remained. The \$40,000 is subtracted from her \$5,340,000 (2014) Lifetime Exclusion amount, leaving \$5,300,000 of the credit to be used for future gifts or at the time of her death. No gift tax is payable until the total Lifetime Exclusion amount is used up. However, a gift tax return (IRS Form 709) must be filed on gifts to any individual, other than your spouse, when the gift exceeds the annual \$14,000 exclusion. Be careful not to get caught on a technicality. If you give a \$14,000 gift and later in the year give a \$100 birthday gift to the same individual, technically you have exceeded the \$14,000 allowable gift and may be required to file a gift tax return. No tax is due while you are alive but the IRS 709 form should be filed.

In summary:

- Annual gifts of \$14,000 per person or \$28,000 per couple or less: no tax and no IRS Form 709
- Annual gifts between \$14,001 - maximum federal exclusion per person or \$28,001 - maximum exclusion per couple: no tax while you are alive but must file IRS Form 709
- Annual/lifetime gifts in excess of the federal Lifetime Gift Exclusion amount (individual): tax due April 15 of year follow year of gift and file IRS Form 709

Gifts are always valued at fair market value (FMV) at the time of the gift. As long as the FMV of the property gifted is less than the \$14,000 per year per person (\$28,000 for couples) annual exclusion, no gift taxes will be imposed. In addition, you can give unlimited gifts to your spouse (called the Marital Deduction) or to a qualifying charity in any year with no gift tax consequences.

If there is any tax due resulting from a gift, the tax is generally paid by the donor, not the recipient of the gift.

Federal gift tax and federal estate tax are intertwined. Any gift in excess of the federal annual exclusion amount must be recorded on IRS Form 709. Once that individual dies, the amounts on their 709 forms are added up and this total amount of gifts in excess of the annual exclusion amount are added back into the decedent's estate, increasing the size of the estate, and to determine if any federal estate tax is due.

### **Minnesota Gift Tax:**

The Minnesota Gift Tax law that was to take effect July 1, 2013 was repealed to the effective date of July 1, 2013 through MN legislation that was signed into law on March 21, 2014.

For property located in MN, the value of gifts in excess of the annual exclusion amount (recorded on the IRS 709 form) made within 3 years of the decedent's death will be added back into the decedent's estate to determine if MN estate tax is due. The 3 year add back provision is retroactive applying to estates of decedents dying after Dec. 31, 2012.

The MN gift add back provision applies to the transfer of property located in MN only. The add back applies to MN residents. It also applies to gifts of real estate and tangible personal property located in MN but owned by any non-resident to determine if the non-resident must file a MN estate tax return.

MN residents transferring real and tangible personal property located outside MN are not subject to the MN gift add back provision.

### **Income Tax Implications:**

Gifts of cash do not subject the recipient to income tax. Gifts of stock, real estate or equipment are also exempt from income taxation upon receipt of the gift. However, when you receive a gift, the adjusted basis (original cost) of the gift remains that of the donor. If the recipient sells the property and it has appreciated in value, they will generally pay capital gain tax on the difference between the sale price and the donor's adjusted basis.

### **Gifting Grain:**

If a cash basis farmer gifts grain to his/her children, the farmer does not include the grain as income on his/her tax return. If gifted in the same year produced, the farmer must reduce Schedule F expenses commensurate with that amount of grain gifted. The child must include the sale of grain on his/her tax return, less any basis which might have been passed on by the donor. Generally, raised grain has no basis. Gifting grain can reduce a farmer's income and self-employment (SE) tax. The sale of the gifted grain increases the child's income, but the child pays no SE tax on the gift of grain. Two possible savings can result: 1) the grain is taxed at the child's tax rate which is possibly lower and 2) no one pays the 15.3% SE tax on the grain sale. Be careful when gifting grain to children. There are limitations on the amount of unearned income that can be taxed at the child's tax rate. Amounts above this threshold will be taxed at

the parent's rate which may be higher ("Kiddie" tax provision). See your accountant or tax preparer.

### **Documenting Gifts:**

When gifting, it is important to document the gift. To document a gift, state in writing that a gift was made including a description of the item, the date given, the value of the gift, a serial and model number, adjusted basis, FMV, etc. Both parties should sign and date the document and the document should be notarized. If the gifted property is a titled asset such as a vehicle or real estate, transferring the title serves as documentation that a gift has been made. Without proper documentation, tax authorities may dispute that a gift ever really took place and may include the gifted property in your estate or assign the income tax liability to the donor if the property is later sold by the donee. Documentation can also serve to notify the recipient's lender that the recipient is now the owner of the property. It will allow the donor to increase the assets on their financial statement. Such documentation can also avoid any misunderstanding or potential arguments between family members. Even though an IRS Form 709 may not be required, it is good practice to list the recipient's basis in the gift.

### **Completing Gifts:**

If you truly gift property, you cannot retain any control of the property. If you do, your gift will be considered incomplete and therefore not a gift for income or gift tax purposes. Retaining interest, control, or income will result in the gift being considered incomplete.

### **Gifting Land:**

You can gift land by deeding over actual acres. You might give the west 20 acres to John and the east 20 acres to Mary. Giving actual acres requires legal work and legal descriptions of the property when each gift is given. You can also gift land by deeding an undivided interest in property to children. You can give a 10% interest in the 160 acres to John & Mary (together or separately) and this may require less legal work.

A business entity, such as one of the many partnership entities or corporations, can also be used to gift land. The business entity holds the land and the shareholders (usually parents) simply gift shares to Mary and John over time.

### **Gifting Contract for Deed Payments:**

If you wish to forgive debt payments from your farming heir, the best procedure is to receive a check for the principal and interest payment and then issue a check back to the child for any gift you

wish to make. Ignoring the check exchange can result in the farming heir not having complete evidence of having paid for the property. You must declare payments received on a contract on your tax return.

#### **Charitable Giving:**

Some people prefer to give to their favorite charity or religious organization. Doing so can provide you with an income tax deduction. If you have appreciated property, a charitable remainder trust allows you receive an income stream, much like an annuity, from the donated asset with the remainder going to charity.

#### **Can You Afford It? What About My Goals?**

Gifts are a very useful estate planning tool. However, don't do it unless you can afford to give up the assets. If gifting jeopardizes your financial security, proceed carefully. Do not impoverish yourself in order to get a farming heir started in farming. If gifting violates your business transition and estate planning goals, do not do it.

#### **Medicaid law change regarding gifting:**

With the signing into law of the Deficit Reduction Act of 2005 on Feb. 8, 2006, there is now a 60 month disclosure period on all non-compensated transfers including gifts. Technically this includes such things as birthday and Christmas gifts as well as donations to your church. Gifting can create a period of ineligibility for an individual regarding Medicaid coverage for a period beginning the date of Medicaid application. For more information on this issue see the following information sheet in this series: *Estate Planning Series #9-Long-Term Health Care Planning*

Consult an elder law attorney for more information specific to your situation.

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

# Tax Issues for Estate Planning

Estate Planning Series #7 5/2014

## Agricultural Business Management

Gary A. Hachfeld, David B. Bau, & C. Robert Holcomb, Extension Educators

### Introduction:

Some of the most costly mistakes in estate planning occur when tax aspects are ignored. A good estate plan encompasses your personal wishes and goals; accomplishes good legal, estate tax, and financial outcomes; and accomplishes positive tax results as well. Following are the major income tax provisions to examine as you plan your estate.

### Income Tax Basis:

When selling an asset, you pay tax on the difference between the selling price and adjusted basis (original cost plus improvements minus depreciation) of the asset.

Example: If you sell land for \$800,000 and your adjusted basis (cost) for the land is \$20,000, your taxable gain is \$780,000.

Basis is your cost to recover when you sell an asset. The basis is determined by how you acquired the asset.

### If You Purchased the Asset:

Your basis is what you paid for the asset plus improvements minus any depreciation you have claimed on it.

Example: If you purchased a rental house for \$50,000 and depreciated it for three years claiming a total of \$5,000 depreciation, your adjusted basis would be \$45,000.

### If You Inherited the Asset:

Your basis is the Fair Market Value (FMV) or special use value assigned the asset as it passed through the estate.

Example: You inherit land from your mother that is valued in her estate at \$980,000. Her basis is \$40,000. Your adjusted basis is \$980,000. If you sell it for \$980,000 you have no capital gains tax consequences.

### If You Received the Asset as a Gift:

Your basis is the same as the donor's basis.

Example: You received a gift of XYZ stock valued at \$120,000 but having a basis (donor's purchase price) of \$25,000. Your basis is also \$25,000. If you

sell the stock for \$120,000; you have a \$95,000 taxable capital gain. **Note:** it is good practice to file a gift tax Form 709 even though no gift tax is due. This process constitutes "adequate disclosure" and can eliminate future gift tax issues.

Basis is extremely important to property holders because it determines the amount of tax they will pay on the sale of an asset. Assets that are inherited and pass through an estate receive a new or "stepped up" basis. The stepped up basis is usually the FMV on the date of death. This provides a strong incentive to hold low basis property until death to achieve the stepped up valuation for heirs.

Example: Sally Smith sold 160 acres of farmland for \$6,000 per acre or \$960,000. It had a basis of \$100,000. Her taxable gain (whether sold for cash or by installment method) is \$860,000. Because of the sale, either she or her heirs must pay capital gains tax on the \$860,000 gain. If Sally had retained the property until her death, the estate would assign a stepped up basis of \$960,000 (FMV). The heirs could then sell the property for that amount and pay no capital gains tax.

### Installment Sales:

Many people report sales of property on the installment method. This allows the taxation to be spread out proportionally during the years that principal payments are made (Note: this applies to land only. An installment sale of machinery or livestock requires payment of all tax in the first year of the sale). This option may be useful to keep as many dollars in the lower tax brackets as possible. Using installment reporting late in life on low basis assets may not be wise because no stepped up basis is received on installment contracts. Heirs inheriting the contract must continue to pay income taxes on the principal and interest payments as they receive them.

Example: You own 40 acres of land worth \$208,000. You have a basis (purchase cost) of \$10,000 in the land. At age 85 you sell the land to your son for \$208,000 on an installment contract payable over 20 years. Your profit ratio on the amount of each principal

payment that is taxable would be 95.19% (the \$198,000 profit ÷ \$208,000 sale price = 95.19%). You receive principal payments of \$10,500 each year for 4 years. Each year you include 95.19% of \$10,500 or \$9,995 as taxable income on your tax return plus any interest received. At age 89 you die, leaving the contract equally to your two daughters and your son. Your two daughters will continue to receive 2/3 of the \$10,500 annually and must include 93.75% of the amount on their tax return for the remaining 16 years of the contract.

If you had kept the property in your estate and not sold it, it would have passed to your children valued at \$208,000 (stepped up basis) and they would owe no tax if they sold the property for that value.

### **Personal Residence:**

If you sell your farm, which includes your personal residence, consider parceling out the house sale because it qualifies for a possible exemption from tax.

For sales after May 5, 1997, homeowners can exclude from gross income up to \$250,000 per individual of gain (\$500,000 for joint filers). You must have owned your home and lived in it for a period of two of the past five years prior to the sale. You need not buy a replacement home to qualify for this tax exemption.

These provisions apply to the house only, not to land or buildings used as business property.

### **1031 Like-Kind Exchange:**

Selling property outright will cause a taxable event. If you have improved land or buildings, a like-kind tax free exchange, known as an IRS Section 1031 Exchange, might be considered. You find a person who has property that is "like-kind" to yours and work out a trade. Your tax basis follows to the new property. It is a complicated tax process, but can position the younger generation on the home farm. Using the tax-free exchange can avoid or postpone taxation of the parent's capital gains on low basis property. To qualify you have 45 days from the transaction to locate a like-kind property, 180 days to close the transaction for the new property, and you cannot take possession of any money exchanged as a result of the transaction. This can be complicated so seek legal assistance.

### **Income Averaging:**

Qualifying farmers are currently allowed to use "income averaging". This provision allows high income from a current year to be carried back equally to utilize lower tax brackets from the three previous years. This provision can help reduce income taxes for retiring farmers. See your accountant or tax preparer.

### **Spread Out Income:**

In most cases, as a farmer retires and they sell off their farm business assets, a large self-employment and income tax bill may emerge depending upon the type of asset. It may be wise to plan ahead and spread the final sales over a two or three year period. Leveling out income usually results in lower taxes paid than does bunching income into one year.

### **Capital Gains:**

In 2003, Federal Capital Gains tax rates were lowered to 5% for individuals in the 10 & 15% federal tax brackets and 15% for individuals in the 25% and greater federal tax bracket. In 2013, federal capital gains tax rates are 0%, 15%, 20%, 25%, & 28%. The new 2013 tax law allows taxpayers to pay federal capital gains tax at a 0% or 15% rate, depending on taxable income level, for many long-term capital gains assets. Those items include stocks, bonds, and land held longer than one year, as well as some raised breeding stock. Farm building sales are taxed at 25% and collectables at 28%.

Keep in mind that the 0% capital gain tax rate applies **only** to the amount of gain between your taxable income and the top of the 15% federal income tax bracket. Gain amounts in excess of the 15% income tax bracket will be taxed at the 15% rate. The new 20% rate applies to individuals in the 39.6% federal income tax bracket with income in excess of \$450,000 married filing jointly, \$400,000 for individuals and \$425,000 filing head of household. State taxes, if applicable, must also be paid on capital gains. Care should be taken when planning a transfer to maximize use of the lower tax rates available on capital assets. Sales of capital assets may not be subject to any self-employment tax. Consult with your accountant and attorney for the best strategy for minimizing the tax consequence of any transaction.

In Minnesota, capital gains are taxed as ordinary income at rates of 5.35, 7.05%, 7.85% and 9.85%.

### **Tax Code Complexity:**

Each provision of the tax code listed above is very complex. When planning your estate and farm business transfer, seek good tax and legal advice. Bad decisions can be costly.

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# Life Insurance in Estate Planning

Estate Planning Series #8 5/2014

## Agricultural Business Management

Gary A. Hachfeld, David B. Bau, & C. Robert Holcomb, Extension Educators

### Introduction:

Life insurance can provide needed funds for survivors upon the death of the insured. For most families, the need for life insurance is greatest early in life. Children are young and the financial burden of supporting the family are the greatest and create the need for life insurance. Ironically, families with the greatest need also are those who probably can least afford the life insurance premiums. The need for life insurance usually decreases as family's age and accumulate more assets and net worth.

### Types of Insurance:

There are two major types of life insurance. They are term insurance and whole or universal life insurance.

Term insurance is purchased on an annual basis and usually increases in cost as a person gets older. Term insurance pays out at death if kept in force by paying the premiums until death. All premiums are used to pay for the cost of the insurance and no cash value accumulates as a result of having the policy. You pay a year's premium for a year's coverage. Several varieties of term insurance are available including declining death benefits for a fixed annual premium and fixed benefits with a rising premium. Term insurance is much like fire, wind, auto, and medical insurance - you pay purely for the protection with no cash value accumulation.

Whole or universal life insurance is term insurance with an accompanying savings plan built in. There are many varieties of whole life insurance, all of which combine a savings plan along with the insurance protection. The cash "savings" value buildup can be borrowed at a rate of interest specified in the policy or taken out if the policy is terminated.

Premium payments are obviously higher for a given amount of whole life insurance compared to term insurance, since a portion of the premium is allocated to purchase a savings plan.

### Uses of Life Insurance in Estate Planning:

Life insurance can be used for many functions in estate planning.

1. Life insurance can be purchased on an individual to provide funds for the surviving spouse or children when death occurs.
2. Whole life insurance can be purchased to provide income to the parents at retirement. This can occur by converting the policy to an annuity or by withdrawing the cash value.
3. Insurance can provide dollars that can be passed as an inheritance to the non-farm heirs. That allows farm assets to flow to farming heirs. The insurance dollars offset the farm assets and therefore all family members receive something from the estate while preserving the farm or business intact.
4. Life insurance can be used to provide funds for the payment of estate taxes, estate settlement costs or debt obligations of the deceased.
5. Insurance can be purchased by the farming heir/heirs on their farming parents. It will provide income, at the time of the parent's death, for the buyout of land, machinery or operating assets from other heirs, if the parents have distributed their farm assets equally among all their children.

**Note:** a critical factor here is that the farm or business heir owns the policy and makes all the premium payments. The farming parent or parents are the insured. The policy beneficiaries are the farm or business heirs. Using this format will insure the death benefits go to the intended people.

6. Farming partners often buy insurance on each other. This process provides funds for buying out the deceased partner's assets if a premature death occurs. The end result is that it enables the living partner to keep the farm or business intact.
7. Life insurance can be used to create or enhance an estate. It can be an estate building plan providing money to heirs.
8. There are new life insurance choices that enable people to draw on the death benefit to cover long-term health care costs. This can be beneficial for someone who may not qualify for long-term care insurance but would qualify for life insurance. Check with your insurance agent.

### **Who Should Own Your Policy?**

Ownership of the policy is sometimes treated lightly but is an important consideration, particularly in large estates. Generally, death benefits from life insurance are included in the estate of the owner of the policy, regardless of who is paying the insurance premium or who is named beneficiary. A change in ownership of a life insurance policy is a complex matter. One should review ownership provisions with an expert estate planner or insurance agent.

For example, even though you transfer ownership of a life insurance policy, if done within 3 years of death, the death benefits will most likely be included in the estate value of the original owner. In addition, the new owner can change the beneficiary, borrow on the policy or surrender or cancel the policy. Care should be taken in changing ownership if relationships are unstable or if there is any question about competency or intention of the new owner.

### **Establishing Beneficiaries:**

Beneficiaries are the people who will get the death benefit proceeds of your life insurance.

If your estate is the beneficiary of your life insurance, the plan established in your Will or trust determines the distribution of death benefits.

Most husbands designate their spouse as the beneficiary if she survives him. If she doesn't, it goes to a trust for the children or directly to the children. Wives similarly often name the husband as beneficiary with the children as secondary beneficiaries. The final beneficiary designee may be the estate if no immediate family member survives. A potential problem with this strategy is the insurance death benefit amount can increase the estate to a value above the Applicable Exclusion Exemption amount for state and federal estate taxes. That causes an estate tax problem. This issue can be avoided if you place the life insurance in an Irrevocable Life Insurance Trust (ILIT). The trust owns the policy but you are the insured. Because you do not own it, the death benefit is not included in your estate value but you have the protection of the insurance. This is a complex area so consult your attorney and insurance agent.

Keep in mind that the insurance company makes ONE tax free payment of benefits. If the payment is to a trust and then later to a spouse or to children, that second payment becomes a taxable event, if there has been growth or income.

### **Note:**

1) The entire amount of the benefit paid out to your beneficiaries or estate is included in your gross estate value for estate tax purposes **if you are the**

**owner of the policy.** Many individuals create a taxable estate through purchasing life insurance that they did not realize will be included in their estate at death.

2) Life insurance proceeds paid to beneficiaries is not considered income to them for tax purposes.

### **Irrevocable Life Insurance Trust (ILIT):**

An ILIT can be of use in two ways. First, to avoid having to include the death benefit amount of a life insurance policy you own in your estate net worth, the insurance policy can be placed into an ILIT. The trust owns the policy and therefore the value is not included in your estate value. Second, if your business entity purchases life insurance for the owner/operators of the entity the insurance can also be placed into an ILIT. That prevents an individual who chooses to leave the entity from taking some of the insurance cash value with them. The ILIT preserves the insurance intact for those who remain in the entity.

There are rules that need to be followed. The ILIT must be titled John & Jane Smith, Irrevocable Life Insurance Trust dated 1-12-14, Junior Smith, Trustee. The ILIT must have its own checking account and the address on the policy must be that of the trustee

### **In-Force Illustration:**

If you own a whole or universal life insurance policy purchased a number of years ago, it would be advisable to contact your insurance agent and request an in-force illustration. This process will help you assess how long the insurance policy will remain in-force. Is it going to be available at your death or has the cash value declined to a point where the insurance lapses? This is a critical issue if the insurance was purchased a number of years ago and is a key part of your estate plan.

### **Conclusion:**

Life insurance can play a vital role in estate planning. It is important to coordinate all aspects of life insurance with your overall estate plan. Carefully analyze all factors before purchasing life insurance. Continue to evaluate your life insurance as family, estate and business needs change throughout your lifetime.

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# Long-Term Health Care Planning

Estate Planning Series #9 5/2014

## Agricultural Business Management

Gary A. Hachfeld, Extension Educator

### Introduction:

Long-term health care has become a major issue for farm families who want to transition the farm business to the next generation. A long-term health care plan is essential as part of the estate plan to insure the business transitions as the family desires. Long-term care costs have skyrocketed. Without a plan, the farm business is facing a potentially huge financial risk due to the cost of long-term care.

This information sheet outlines what long-term care is, the statistics around the probability of needing long-term care, some of the terms involved, an explanation of the federal Medicare and Medicaid program qualification guidelines, methods of paying for long-term care and the long-term care partnership program.

Each individual has to decide how they will deal with long-term health care costs if the need arises. This is a personal choice and every individual has a different set of circumstances. ***The information in this document is not meant to imply one choice over another - that is, whether one should shelter their assets and go onto Medicaid if at all possible OR one should pay their own long-term care costs. The information contained herein is to simply outline the rules around how the various programs work, to dispel misconceptions about the various programs available, and to outline some ideas to help you think about long-term health care planning.***

### Long-Term Care Defined:

#### Insurance definition:

Long-term care designation for insurance purposes means an individual is certified chronically ill by a physician for a period of at least 90 days. Being chronically ill means requiring assistance with at least two of the six Activities of Daily Living (ADL). The ADL include bathing, dressing, eating, toileting, transfer (mobility), and continence, in that order.

#### Medicaid definite:

Medicaid (Medical Assistance or MA as it is referred to in MN) requires assistance with two of the six activities of daily living (new as of July 1, 2011) and needs 24 hour care.

Long-term care includes a wide range of care options. Those include care given in the home by a family member or home health care aid, congregate care and groups homes, assisted living and nursing home.

### Probability of Needing Long-Term Care:

According to several federal governmental agencies and insurance companies, the actual risk for needing long-term care is greater than 50%. If you have a spouse, overall risk of one partner needing long-term care is greater than 65%.

Currently 1 in 2 Americans, over the age of 65, will have an extended nursing home stay (does not include any type of home stay). Also, 1 in 10 Americans over the age of 65 will have a nursing home stay of more than 5 years. The average nursing home stay is 2 1/2 to 3 years. Of those folks currently receiving long-term health care, 40% are under the age of 65.

Data for the length of time care is provided shows the following:

- 32% needing care → less than 1 year
- 26% needing care → 1-2 years
- 18% needing care → 3-7 years
- 24% needing care → 8+ years

For family members who delivered the care in their home, a total of 42% of the caregivers report the care recipient resided in the home for a period of 3 years or more.

For the caregiver who delivers care in their home, their immune systems ability to fight disease decreases 18% on average. The caregiver's life expectancy decreases by 3 - 4 years on average. The number one health care issue for caregivers is depression.

### Long-Term Care Terms:

Long-term Care: Includes a wide range of care from in-home care to the nursing home.

Medicare: Is the federal health insurance program

for people who are age 65 or older, disabled, blind, or have permanent kidney failure.

**Medicaid:** a federal program, known as Medical Assistance (MA) in Minnesota, which provides health care payments for needy people. The program is administered by each county human services department.

**Long-Term Care Spouse:** referred to as the nursing home (NH) spouse. This is the person who is married to a CS and resides in a long-term health care facility. They may or may not be receiving MA-LTC payments.

**Community Spouse (CS):** person/spouse who does not reside in a long-term care facility or receive services through a waiver program and is married to a long-term care spouse.

**Medical Assistance – Long-Term Care (MA-LTC):** This is the Medicaid (MA) program that pays only for custodial/skilled long-term care stay costs.

**Elderly Waiver (MA-EW):** This is the Medicaid (MA) program that pays for assisted living, group residential and home care.

### **Long-Term Care Costs:**

Long-term care costs are based upon level of care and the care facility. Listed here are current annual cost ranges by facility and care level for Minnesota.

- Home Health Aide: \$38,000 to \$58,000
- Assisted Living: \$30,000 to \$55,000
- Nursing Home:
  - Semi-private: \$63,000 to \$80,000
  - Private room: \$66,000 to \$95,000

### **Medicare:**

Medicare is a federal health care program that Americans qualify for at age 65. It is not intended to pay for long-term custodial health care.

Medicare will pay for a portion of a nursing home stays **IF** the stay is for doctor ordered recuperative care - physical therapy, speech therapy, etc. To qualify, one must have a minimum of a three day "admitted" hospital stay before being discharged to the nursing home. Being in the hospital for "observation" does not qualify the patient for Medicare coverage if discharged to the nursing home.

The nursing home must be a Medicare approved nursing home. All nursing homes in Minnesota

qualify. However, if you winter in another state or retire in another state, that may not be the case. On average, 48% of nursing homes in other states are not Medicare approved.

In addition to the nursing home stay having to be for doctor ordered recuperative care, the patient must show improvement. If not, Medicare payment will stop and the patient will have to self-pay for any additional time in the nursing home. If the doctor ceases to order care, Medicare will stop paying.

For a Medicare approved stay in a nursing home, Medicare will pay toward the first 100 days of the stay. Medicare pays 100% of the cost through the first 20 days if doctor ordered care continues and the patient shows improvement in condition. For days 21 through 100, Medicare pays all but the daily co-pay (number changes frequently). This amount has to be paid for by the patient. For days 101 and beyond, Medicare pays nothing. Medicare will also stop paying if the doctor ceases ordered recuperative care or the patient fails to show any improvement in their condition. Bottom line, Medicare will not pay for an extended long-term health care facility stay.

### **Veterans Benefits:**

To qualify for VA benefits you must often meet specific asset and income requirements much like Medicaid. You must have wartime service of at least 90 days and 1 day of war time to qualify. **Note:** wartime service dates are determined by Congress, not by actual dates of a war. In addition, you must have a service connected (SC) disability to qualify.

To be placed in a VA Community Living Center (VA Nursing home) you would require nursing home care for a service connected disability and are rated as having a 60% SC disability and unemployable and requiring nursing home care for your disability **OR** you have a combined SC disability percentage of 70% or more and require nursing home care for the condition.

A second alternative would be placement in a contract nursing home based upon space and availability.

This is a very complex area and proper planning must be done to qualify. See an attorney versed in MA and long-term care issues as well as your county veteran services officer.

### **Medicaid:**

Medicaid or Medical Assistance (MA) as it is referred to in Minnesota, is a program that assists with health

care payments for the needy. MA-LTC pays for custodial/skilled long-term care stays in qualified facilities.

For MA eligibility there is a residency requirement. The applicant must be living in the state with the intent to remain permanently or for an indefinite period of time or living in the state with a job commitment or seeking employment whether or not currently employed. In addition, the person cannot be maintaining a home outside the state. Categorical eligibility states a qualified person must be over age 65, blind, or disabled.

For financial eligibility a person must also meet certain asset-resource requirements, asset transfer requirements, and an income test.

### **Asset Assessment Process:**

Regarding asset limitations, a person applying for MA-LTC in MN cannot own more than \$3,000 of assets to qualify for MA benefits. If the applicant has a spouse, the couple's assets will be assessed through a process referred to as Asset Assessment. This takes place the first date the spouse entered into long-term care or stayed for 30 continuous days. This stay may have been years ago or the date the person entered the care facility for the first time.

Assets are split 50/50 between spouses. The CS is allowed to keep a given amount of assets valued within a range of maximum/minimum - this amount changes each year.

Once assets have been assessed, they are deemed Countable, Unavailable, or Excluded from the asset limit of \$3,000 per person in MN.

**Countable Assets** are assets that are counted against the asset limit (\$3,000 per person in MN) when establishing eligibility. These assets are deemed available to pay for long-term care costs. Available assets include:

- All cash accounts regardless of ownership (does not matter if the account is in one spouse's name only and prenuptial agreements have no bearing on this) .
- Jointly owned cash accounts unless the contribution by the joint owner can be proven.
- Any investments accounts, stocks, bonds, CDs, etc.
- Life insurance in excess of \$1,500 cash value.

- Boats, motor-homes, camping trailers, other tilted vehicles except one vehicle of any value.
- Non-homestead real estate (non-contiguous farm land, cabin, timeshare, retail business, etc.).
- Pensions that can be taken in a lump sum payment.
- Most trusts in which the MA-LTC applicant has an interest.
- Any personal property purchased for investment purposes (guns, coins, jewelry etc.).

**Unavailable Assets** are assets that are disregarded at the time of application unless there is no spouse, assets are sold, or converted. Unavailable assets include:

- Gifted assets that have survived the 60 month look-back period.
- Irrevocable pre-paid burials (if done correctly).
- Some jointly held assets if owned with someone other than spouse - lien will be filed on property when the applicant qualifies for MA-LTC.
- Life Estate if established **before** August 1, 2003.
- Irrevocable Trusts established **prior to** July 1, 2005 and grantor has no control over trust assets.
- Irrevocable Trusts established **on or after** July 1, 2005 and 60 months has passed before applying for MA.

**Excluded Assets** are assets not counted against the asset limit when establishing eligibility. These assets can become available assets upon the death of the CS or CS enters the long-term care facility. Excluded assets include:

- Primary residence and all **contiguous acres**. The rules here are that the CS must have resided in residence on asset assessment date **or** certain family members reside in the home **or** there is a physician's statement verifying the person **will** eventually return to the residence. Land separated by a road or railroad right-of-way, a stream or river,

drainage ditch, etc. are considered contiguous.

- One vehicle of any value.
- Personal property that has cultural or religious significance.
- Income producing assets to meet the CS allowance or business property.
- Life insurance with less than \$1,500 of cash value.

### Asset Spend-Down Rules:

To qualify for MA-LTC, the applicant cannot own more than \$3,000 worth of assets. If the applicant has assets and wants to qualify for MA-LTC, they must spend down (liquidate) those assets to no more than \$3,000 to qualify.

In the following example, John and Jane are still farming. John had a major health issue and is forced to enter the nursing home. Assets were evaluated and allocated based upon the asset assessment process. Following is the example results:

John's Assets	Jane's Assets
Farmland: not contiguous \$180,000	House \$200,000
John's IRA \$120,000	Contiguous Farm Land \$1,080,000
Jane's 401K \$81,000	Buildings \$275,000
Joint Savings \$20,320	Machinery \$450,000
John's Car \$8,000	Joint Checking \$3,600
	Joint Savings \$8,320
	Jane's Car \$24,000
	Cabin \$100,000
	John's Boat \$4,000
	Pre-paid Burial \$12,000
<b>\$409,320</b>	<b>\$2,156,920</b>

Typically assets such as joint accounts, a cabin, boat, etc. would be countable assets. The exception here is that they are on Jane's side of the ledger because she needs them to reach here resource allowance amount (number changes Jan. 1 each year).

The farm land acres that are an unavailable asset have to be contiguous to one another.

The farm land, buildings and machinery in this example are all excluded assets as well because Jane plans to continue farming. If she were to die before John dies or she enters the nursing home, all

the assets on her side of the ledger will become available assets.

Lastly, for John to qualify for MA-LTC in MN, he would have to **spend down** or liquidate the \$409,320 on his side of the ledger to no more than \$3,000. Owning more than \$3,000 of assets would make John ineligible for MA-LTC in MN.

Having to spend-down that amount of assets places the farm family and the farm business at huge financial risk. The result could mean the farm business can no longer continue.

### Resource Allowance Rules:

If one spouse enters the nursing home, the CS is allowed a given amount of assets calculated via the asset assessment process. The amount of additional assets above the 50/50 split is determined by federal Medicaid rules and is referred to as the Community Spouse Resource Allowance as shown in the John & Jane example. This number changes each year on January 1. The assets are unavailable and can include items from the countable list outlined earlier in this document. They remain unavailable until the CS dies or enters the nursing home upon which the assets become countable assets for MA if the NH spouse remains in the nursing home at the CS death.

### Income Rules:

The CS under current MA rules is allowed to keep all the income in their name. The CS is also allowed to keep an additional amount of the NH spouse's assets necessary to generate additional income at a given level for the CS. This qualified income level changes each year. Every couple or person's situation is different.

In the John and Jane example, the farm income would be divided equally between John and Jane because they file a joint tax return. If that income added to any other income Jane has, meets or exceeds the qualified income amount for Jane, she gets to keep the income. John's share of the income, minus a small monthly allowance, goes to pay for his long-term health care costs. If John's income falls short of his total long-term care costs **and** he qualifies for MA-LTC through the spend down process, the MA-LTC program would pay for the short fall. When John qualifies for MA, the Department of Human Services (DHS) will file a lien on his assets and upon the death of both John and Jane, DHS will pursue the lien and garner assets equal to John's long-term care costs or the total value of the assets whichever is less. Again this can place a financial burden on the farm business.

A new MN law slated to take effect July 1, 2012 would require the CS to pay a percentage of her income toward her spouse's long-term care. This would occur if the CS's gross monthly income exceeded 250% of the Federal Poverty Guidelines (FPG). That number changes each year. This law has been put on hold for the time being but could be enacted at any point. Check with an elder law attorney for information specific to your situation.

### **Gifts Assets:**

A huge misconception of many people is that if I give away all my assets before I have to go into the nursing home, the assets will be protected and I can go onto MA-LTC. That is not true in MN and many other states as well. The Deficit Reduction Act of 2005 passed into law changes the rules for MA-LTC.

One change was the look-back period for gifting when applying for MA-LTC. When applying for MA-LTC, not only do you have to do an asset assessment and comply with income rules, there are asset transfer rules as well. Those rules state that when applying for MA-LTC, you need to disclose any and all gifts given within 60 months of the date of application. A gift includes the obvious outright gift but also include a sale of assets for less than fair market value (FMV) - this is referred to as an uncompensated transfer. The difference between the FMV and the sale price constitutes the amount of the gift.

Let's assume Sarah had made a gift 38 months before going into the nursing home and applying for MA-LTC. Sarah would have to disclose the gift. The DHS case worker would divide the amount of the gift by what is referred to as the Statewide Average Payment to Skilled Nursing Facility (SAPSNF). This is MN's estimate of the average cost of a one month stay in the nursing home. The number changes every year on July 1. The result of that calculation would be the number of months Sarah would be ineligible for the federal MA-LTC program.

In addition to the look-back period change, the Deficit Reduction Act of 2005 also changed the point in time when the penalty period begins. Under the old rules, you may have had a penalty but it started the minute you entered the nursing home. If you had sufficient assets, you could pay your own way in the nursing home until the penalty ran out and you had spent down your assets to no more than \$3,000 in MN. At that time you would qualify for MA-LTC. Under the new rules, if you have a penalty and you entered the nursing home, you would have to spend down your assets to no more than \$3,000 and then the penalty period begins. Once the penalty period

ends, you can apply for MA-LTC. The problem with the new rule is you are facing a penalty period where you have to pay your own long-term care costs but you have spent down your assets to no more than \$3,000 in MN.

Bottom line is that doing no planning and relying on MA-LTC for your long-term health care costs will not work unless you plan to spend down your assets. This could mean liquidating the farm business you wish to transition to the next generation.

### **Financing Long-Term Health Care:**

As described, Medicare does not pay for extended long-term health care costs. To qualify for MA-LTC, you have to spend down a considerable amount of assets in addition to abiding by income and asset transfer rules. Your medical insurance and disability insurance will not pay for you long-term health care costs. There are, however, other options for financing your long-term health care costs. Those choices include family care, self-insure, self-pay, gift away all assets to a child for example and wait 60 months to apply for MA-LTC, place all your assets into an Irrevocable Trust and wait 60 months before applying for MA-LTC or long-term care insurance.

### **Family care:**

Discussed earlier in this document are the issues and challenges of family care. In addition to the toll on the caregiver's health and the costs to family finances, there are fewer children residing near those needing long-term care. There are more women in the workforce and they have tended to be the caregiver in the past. Divorce is a huge issue making it difficult to care for parents. Lastly, people are living longer so care is required for a greater length of time. All these issues can make family care a less than desirable option for many families.

### **Self-Insure:**

To self-insure means to set aside enough money to pay for your long-term health care if needed. There are at least three issues here. One, where is the money going to come from? It no doubt means liquidating assets. Two, how much money am I going to need? The average stay in a nursing home is 2 ½ to 3 years. However, there is on record a person in MN spending 29 years in the nursing home due to Alzheimer's disease. Three, what is my backup plan if I run out of money?

### **Self-Pay:**

To self-pay means paying your own expenses for

long-term health care. Unless you have substantial assets other than the farm assets, to self-pay is to place your farm business at risk. In addition, this method can place strain on family relationships and finances as well.

#### Gift all Assets to Child & Wait 60 Months:

This approach involves gifting all your assets to one of your children for example, relying on them to pay all your living expenses for 60 months, and then applying for MA-LTC if you need to go into a long-term health care facility. This approach is an option but may not be very feasible.

#### Place all Assets into an Irrevocable Trust & Wait 60 Months:

This approach involves transferring all your assets into an Irrevocable Trust and waiting 60 months before applying for MA-LTC. There are a number of issues here. First, you no longer have control of the assets. The trustee of the trust is in control of the assets. Second, you will have to rely on the trustee to pay your living expenses for the 60 month period. Third, you may never go into a long-term health care facility and your assets are no longer owned by you.

#### Long-Term Care Insurance (LTCI):

Purchasing long-term care insurance (LTCI) is a method of paying any long-term care costs. There are two basic types of LTCI - standard and hybrid policies. Standard LTCI pays strictly for long-term care costs. Hybrid LTCI is a new product that combines life insurance with the ability to pay for long-term health care costs.

When purchasing LTCI you will need to make some decisions regarding the type of coverage. Items include the number of years of coverage, the length of the elimination period or the time before the insurance starts to pay, inflation protection, the facilities you want covered in the policy, the payoff period, etc. This should be done in consultation with your insurance agent.

If you plan to pursue checking into LTCI, there are a number of items you need to gather before going to meet with your insurance agent. Those items include:

- Date of birth.
- Any and all health conditions in the past 10 years.

- Any hospital stays in the past 10 years and if so, for what reason.
- Medications: drug name and dosage (amount and frequency).
- Current height and weight.
- Current/past tobacco use.

It will take two or three visits with your insurance agent before you are ready to sign the insurance agreement. It may be in your best interest to evaluate several insurance company policy offerings. Many times this can be done through a single insurance agent. The key is to ask lots of questions before you make a decision. Be sure you know what you are buying and that you understand all aspects of the insurance policy.

#### Long-Term Care Partnership Program:

As part of the Deficit Reduction Act of 2005 signed into law on Feb. 8, 2006, a program referred to as the Long-Term Care Partnership Program was authorized. MN as well as several other states have enacted the program as well.

If you purchase a long-term care insurance policy that qualifies for the Long-Term Care Partnership Program, the insurance will pay for your long-term care costs while protecting an equal amount of assets from MA-LTC, in the event you have to apply.

Example: Helen is currently 58. She purchases a qualified Long-Term Care Partnership program policy with 5 years coverage worth \$922,337 pay-out in 20 years. Helen enters the nursing home in 20 years and starts using the LTCI and eventually uses up the pay-out amount. Her daughter goes to DHS and applies for MA-LTC. The case worker notes that Helen had a qualified Long-Term Care Partnership Program policy worth the \$922,337. Helen's only asset is farm land worth \$1.95 million. Because Helen purchased the qualified LTCI policy, \$922,337 of the farm land value is protected from the MA-LTC spend down requirements. Helen can spend down to the \$3,000 on the lesser amount to qualify and the rest of the farm land is not subject to the MA-LTC rules.

To qualify for the Long-Term Care Partnership Program, a policy must meet several requirements. They are:

- Coverage must be for a MN resident.

- The insurance agent selling the policy must be certified to sell Long-Term Care Partnership Program policies (8 hours initial certification training, 4 hours of training every other year thereafter to remain certified).
- Issue age: certain issue ages require a given level of inflation protection. They are: under age 61 - compound inflation protection; age 61 to 75 - some level of inflation protection (simple or compound); and over age 76 - no inflation protection required.

**Note:** Standard LTCI may qualify for the Long-Term Care Partnership Program. Hybrid LTCI will not.

One additional point about LTHI is that of portability or applicability in another state if initially purchased in MN. If you purchase a policy in MN but then move and retire in say Arizona, you will need to check and see if the policy will be accepted in Arizona.

#### **Irrevocable Pre-paid Burial:**

One strategy for making funds unavailable regarding the \$3,000 asset limit for MA-LTC in MN is to establish an irrevocable pre-paid burial. You set aside funds to pay for funeral expenses.

This process has to be done correctly, adhering to a strict set of rules. It is best to work with a funeral home and certified burial planner. They will establish an irrevocable trust agreement utilizing either a life insurance or annuity contract. They will make “any and all funeral providers as their interest so appears” the beneficiary of the trust. If done correctly, qualified costs include funeral expenses, cemetery space, urn, vault, crypt, casket, headstone, opening & closing of the grave site, and perpetual care. In MN the contract can include up to \$20,000 of funds. If done incorrectly, only \$2,000 can be made unavailable for the \$3,000 MA-LTC asset limit in MN.

If you receive benefits from MA-LTC in MN and upon your death there are any funds remaining in your pre-paid burial fund, those funds go to DHS.

You can establish a pre-paid burial account for the following individuals: your spouse, your parents, your children and their spouses, your siblings and their spouses, step-children and their spouses, and persons related to you by adoption.

#### **Additional Resources:**

There are many resources available to help you in getting background information on the topic of long-term health care planning. You can simply search

the Internet for long-term care and find many helpful items. A few are listed here:

- [www.minnesotahelp.info](http://www.minnesotahelp.info)
- [www.completelongtermcare.com](http://www.completelongtermcare.com)
- [www.longtermcare.gov](http://www.longtermcare.gov)
- [www.financinglongtermcare.umn.edu](http://www.financinglongtermcare.umn.edu)
- [www.genworth.com](http://www.genworth.com)
- [www.johnhancockltc.com](http://www.johnhancockltc.com)

**This is only a very short list and not meant as an endorsement of any specific company.**

If you are looking for information on MA make sure the information you locate is specific to the state in question. Each state’s rules are a bit different. Make sure the information is current. Rules change quickly and often. If LTHC planning is an issue for you, see an elder law attorney for information specific to your situation.

#### **Summary:**

Individual long-term health care planning must be based upon a solid personal estate and business transition plan. This is particularly true when you have a business involved that you may want to pass to the next generation. Components of your estate and business transition plan must include a Will or revocable living trust, power-of-attorney, health care directive, HIPPA authorization (listing of folks you grant access to your medical records) proper asset ownership, all associated contracts and agreements, and a business transition plan. All these things together with your personal long-term health care plan will enable you to achieve your goals for the future.

This information sheet is a simplistic overview of long-term health care planning. As you can tell, the topic is extremely complicated. When you begin to plan for this area of your life, seek the help of an elder law attorney. That is someone who focuses their law practice on the area of long-term health care issues and MA-LTC planning.

Finally, once your plan is complete including the personal estate plan and business transition plan, share your plans with your family. Doing so will inform them of your intentions and your wishes. This action may prevent a family feud upon your death. It also allows them to do planning for the future.

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# Steps in Estate Settlement

Estate Planning Series #10 5/2014

## Agricultural Business Management

Gary A. Hachfeld, David B. Bau, & C. Robert Holcomb, Extension Educators

### Introduction:

The decedent's Will or trust document dictates how their assets will be distributed. Will settlement is done through the court supervised process of probate. If the decedent has no Will, referred to as "dying intestate", the state of residence generally has a procedure that is followed. If the decedent has a simple Will and a surviving spouse, the assets will transfer to the surviving spouse through the probate process. If property is held Tenancy in Common, it is subject to the probate process as well. Trust settlement is a private process and does not require court supervision or probate.

The probate process in the United States is designed to settle the affairs of a deceased individual. It is a court-administered process in which a judge determines if a valid Will exists, decides who will be the personal representative for the decedent's estate, and approves the plan for the distribution of the decedent's assets. The primary function of the probate process is to determine what property was owned by the deceased, to pay off creditors and legally distribute the assets to the rightful heirs. To complete this process many considerations and several steps must be taken. In Minnesota, probate can take on average 12-18 months and can cost as much as an average of 2-3% of the estate value.

If a trust is involved, there will be a trustee or trustees. The trust must go through an administrative phase, the process for closing out the trust. This is a private process, does not involve the court, is not open to the public, and generally costs less and takes less time than probate.

### Locating the Will or Trust Document:

If the decedent has a Will, the estate settlement process usually begins with trying to locate the decedent's most current Will. If a Will can be found, it usually names a personal representative for the estate. If the Will is not found in the home, it most likely is in a safe deposit box. Locating the key or combination is a first order of business. For a trust there will be a trustee or trustees named. They will be in charge of the settlement process. If no Will or trust can be located, you might check with the attorney (or law firm) of the deceased to see if they

have a copy of the Will or trust. Locating the most current Will or trust document is a crucial part of the settlement process.

### Consult An Attorney:

Before going too far with the estate settlement process, you might want to select an attorney to help with the settlement procedure. Select an attorney with whom you are comfortable and who has experience in estate settlement. Your attorney should provide legal and practical guidance to get you through the estate settlement process. You may wish to discuss costs, including attorney's fees, during your first visit. In Minnesota, attorneys cannot base their fees on a percentage of the estate value and therefore most will use an hourly rate. However, some MN attorneys choose to charge a flat fee which must be based upon a "reasonableness" defined and found standard in MN statutes.

### Secure Copies of the Death Certificate:

The personal representative (a Will) or trustee (trust) will need several copies of the official death certificate. Generally the funeral home where the deceased will be prepared will supply you with the death certificates. Insurance companies and other holders of assets will request them before they can make cash payments. Request four or five copies of the official certificate to begin with.

### Inventory Assets:

Another initial step in the process is to inventory and list all assets in the estate. Once a list is finished, a fair market value will need to be assigned to each asset. Large taxable estates may require a certified appraisal. Assets such as land will also need a certified appraisal. Assets should be listed by categories and valuation taken as of the date of death. If the estate decides to use values as of six months after death for tax purposes, valuation will have to be made on that date also. The alternate valuation date is chosen if it reduces the estate tax in large estates or increases the basis of assets passed to heirs in small estates. The inventory and valuations will likely be reviewed by both the attorney as well as the court. The values are usually of vital interest to the beneficiaries.

### **Keep Accurate Records:**

The personal representative or trustee is required to keep accurate records of all estate income and expenses. They should open an estate checking account or continue to use the checking account of the deceased. **Under no circumstances** should personal representative mix personal funds with estate funds, nor should they pay any bills in cash. Keep all checks and receipts for any payments made. The most efficient way to do all this is to establish a good record keeping system. It is also important to keep the beneficiaries informed on a regular basis, as to what is happening with estate assets, projected distribution dates, and any other details they may be interested in.

### **Payment of Claims and Bills:**

The personal representative or trustee is charged with paying all lawful claims of creditors and paying the bills of the deceased. These bills include medical expenses, funeral, utilities, and other outstanding business and personal bills. Keep receipts.

### **Life Insurance:**

Life insurance policies should be located. Companies should be informed of the death and forms should be filed to initiate payments to beneficiaries.

### **Tax Implications:**

Throughout the settlement process, the personal representative or trustee should pay attention to income tax and estate tax possibilities. The attorney or an accountant should be able to give advice on this matter. Perhaps the least understood area of taxation involves the establishment of basis in assets. Basis is the decedent's value in the asset as of the time they acquired it - purchase, gift or inheritance. Basis is the tax cost or expense you deduct when the asset is sold. Heirs get a stepped up basis to fair market value on assets they inherit. It is important that the personal representative or trustee informs them of this basis at the time of asset distribution. Likewise, if the deceased was collecting payments on an installment sale, a certain percentage of the principal is subject to taxation. It is determined by the profit percentage calculated on the sale and used annually to determine taxable income. Since the heirs must continue to pay income tax on the installment contract income, they should be informed of the profit percentage. Heirs will also have to pay income tax on the interest received from installment contracts. Heirs should be informed of any other tax ramifications.

MN requires the value of any gifts given within 3 years of the decedent's death to be added back into the decedent's estate value to determine if any MN

estate tax is due. This also applies to non-MN residents who own real estate or tangible personal property in MN. Finding documentation of any gifts would be necessary in closing a decedent's estate.

### **Convert Assets to Cash:**

Unless the Will or trust advises or stipulates to the contrary, assets are usually sold for cash so that a later cash distribution can be made to beneficiaries. The car, the house, other real estate, mutual funds, etc. are usually sold and receipts deposited in the checking account. If the Will or trust calls for direct distribution of assets to certain heirs, assets would be held until the date of distribution. One exception is if the decedent has a retirement investment account. If allowable, heirs may want to roll the investment into their name and allow it to continue to be invested and to grow in value. Seek the help of a qualified financial planner in this matter.

### **Distribution of Assets:**

One of the final steps is to distribute all assets to the rightful heirs according to the Will, trust agreement, or state intestate laws. If a Will exists, the court must supervise all distribution of assets. If a trust exists, the trustee(s) can distribute the assets according to the trust document. Legal transfer is made of non-cash items and checks are written to heirs. A prudent personal representative or trustee might retain some funds in the checking account if future tax bills are a possibility. If tax contingencies never arise, a later distribution to heirs closes out the estate checking account.

### **File Tax Returns:**

The personal representative or trustee will have to file income tax and estate tax returns on behalf of the decedent. Verify due dates of such returns early in the process so deadlines for filing can be met.

There are many other details, which must be attended to during the settlement period. They may include newspaper notifications, formal appointment of the personal representative or trustee, notification of heirs, determination and payment of personal representative or trustee fees, closing of all accounts, and formal closing of the estate. The attorney will advise the family or personal representative/trustee as to these details as the process proceeds.

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# Distributing Personal & Household Assets

## Agricultural Business Management

Gary A. Hachfeld, David B. Bau, & C. Robert Holcomb, Extension Educators

### Introduction:

There comes a time in life when many people are faced with the question of what to do with their personal possessions. Most elderly people have a life time of accumulated furniture, family heirlooms, prized mementos, photographs and other possessions. These possessions will have to be disposed of in some manner either at retirement, at the time of a move to a health care facility or upon death. Many people are faced with the question of how to dispose of the property in a manner that is fair and meaningful to their heirs.

Disposing of prized possessions can be very emotional and a very difficult thing to do. Often, a life time of memories and events are sparked by certain possessions. It is probably best not to dispose of these possessions until you are emotionally ready to do so.

When you are emotionally ready to dispose of your things, the following suggestions may help you with the process.

### Should I give away things now or let my personal representative/trustee divide them after I'm gone?

Giving away personal property during your lifetime, to people who you want to have it, can be rewarding. You are certain it actually gets to the people you think are the most deserving or appreciative of the item. Your gifting of the possessions moves the property out of your home. This can simplify your life as well as that of your personal representative or trustee or your family members who will have to sort and dispose of your items after your death. You may also receive satisfaction when giving things to others. Gifting to others can make you feel good.

### How can I be fair to all my children? I only have one antique grandfather clock.

Fairness to children is a challenge. Sometimes, knowing your children's likes, dislikes and their interests can give you some guidance when distributing assets. If you have an heir who is particularly interested in family history, you might give them the old family photos and family

history. Consider giving practical household items (beds, tables, etc.) to those who may have a use for them. If you do have one outstanding item and many heirs who want it, you might consider giving that antique grandfather clock to one child, but let the others have offsetting items such as other antiques, your car, major appliances, etc.

Communication and creativity are key here. Following are some hints you might consider when distributing your non-business assets.

### What are some ways I or my personal representative/trustee can divide possessions fairly and more or less equally?

First, decide on what items are to be distributed. Then consider one or more of the following:

1. Hold a private family auction. Allow family members to buy items in open bidding. You can keep the money generated or divide it equally among family members as a means for everyone getting something. The disadvantage here is if a child does not have the finances to bid on items, they are left out of the process.
2. Some families have held a private family auction where all family members receive "monopoly money" to bid with. This approach levels out discrepancies in spendable income and the family members can bid on anything they want until their monopoly money is gone. It can also include multiple generations where you give differing amounts of monopoly money to the different generations.
3. Hold a public auction. Let family members bid with the public. If assets are in an estate, net proceeds from the auction will be divided among heirs. The public auction or even an estate or garage sale can also be a way of disposing of estate assets that no one in the family wants.
4. Draw straws or playing cards for position. The first person or high card chooses an item; person #2 picks an item, then #3 and so on. When the final person has selected, #1 again chooses an item. The rotation of choosing continues until all items are gone. You could

include the person selecting an item tell a story as to why they selected the item and why it has meaning to them.

5. Place your possessions into groups of items having approximately equal value, by your judgment. Then draw numbers among children or grandchildren to determine who gets which group or lot of goods. Children having received a group of items are free to trade or sell selected items to anyone else who may want them.
6. Another idea some families use is to have the children take back any gifts they have given to the parents during their lifetime. Then all remaining possessions are divided using a method listed previously.
7. You might call the family together, go around the house, and ask who might like a given item. There may be a story connected with the item and why it is so precious to a given individual. The challenge here is to determine if all family members are being heard fairly in the process.
8. Various charitable organizations will readily accept items you do not wish to sell or give to family members. Gifting personal goods or appreciated property to charities may also result in a charitable tax deduction.

#### **What if my children seriously disagree on the division of my stuff?**

If all of your children want Grandma's rocking chair or the blue dishes, you have a problem. If you give it to one, the others will be upset. Consider auctioning it or drawing straws as indicated previously. It may take the pressure off of your decision if they had a chance but luck wasn't with them.

#### **What can I do to make dealing with my "stuff" easier for my kids if I die?**

1. Clean out and throw away old, useless, unnecessary paper. Keep proof of purchase on major items you still own like cars, houses, and real estate. Old (over 5 years) business papers like receipts, checks, and deposit tickets can be discarded. Other old useless and worthless items could also be thrown out. It may be a good idea to keep your account or record books and income tax returns permanently. File them in an orderly manner for disposition after your death. You should also keep legal forms relating to retirement accounts, deeds, contracts, machinery that has been gifted and current rent agreements.
2. Sell or give away some of your personal possessions now if you don't need them and won't ever need them. Simplify your affairs by

ridding yourself of it. Be careful. Some things you feel are junk may have significant value as a collectable, antique, or a family memento. Only throw real junk out. It may be wise to have another family member or two, who are knowledgeable about values of older things, assist you with the process.

3. You may want to consider making an accounting on paper of your most treasured family heirlooms. List the item, where it came from and why it is significant. Provide the listing to the family members so they will know who owned it and some of the family history relating to it. Asking someone to capture you on video or DVD with each heirloom as you describe and explain its history, is an easy way to do this.
4. If you have any special requests regarding who should get certain personal effects when you die, prepare a letter of instruction. Describe each item and who you want to receive it. Make several copies of this letter for family members and attorney. It is then readily available when you're Will or trust is administered. Your Will or trust may refer to this letter and describe its location. Placing a tag on each possession indicating who should get it is probably not the best way to indicate your intentions. Tags can be lost, removed, altered or switched by dissatisfied family members if they are aware the possession has a tag on it.

Distributing prized possessions can evoke feelings of sadness and loss or it can be satisfying. Eventually your possessions will pass on to someone else. Your decision on how you want that to happen should not be postponed if you have strong feelings about how you want things distributed. It is probably better for you, as a parent, to decide on the distribution of your assets rather than letting your children disagree over the assets after your death. After deciding on the distribution, it is also important to communicate with the family about your wishes so there are no misunderstandings.

For additional information on transferring personal property, go to [www.yellowpieplate.umn.edu](http://www.yellowpieplate.umn.edu).

Distribution of personal assets is important, but no more important than a good overall estate plan. Begin the process today!

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# Maintaining Farm Land Homestead Classification and Qualification for Minnesota \$4 Million Qualified Small Business Property Qualified Farm Property Exclusion

## Agricultural Business Management

Gary A. Hachfeld, Extension Educators

### Introduction:

During the 2011 Minnesota legislative session, state lawmakers initiated a Qualified Small Business Property & Qualified Farm Property Exclusion relating to the Minnesota estate tax. The \$4 million dollar Minnesota estate tax exclusion for qualified small business and qualified farm property was signed into law July 2011 for decedents dying after June 30, 2011. The exclusion is per qualifying individual and is in addition to the Minnesota additional estate tax exclusion available to every individual in the state.

Legislative law tied qualifying for the farm property exclusion to maintaining homestead classification on farm land until death. If homestead classification is lost before the decedent's death, the estate will not qualify for the additional exclusion. Many folks feel qualifying is not going to be a problem and the exclusion is a panacea for eliminating Minnesota estate tax upon their death. However, without planning and maintaining homestead classification, there could be major issues.

Following is a list of farm land ownership and homestead classification scenarios. Note there are several scenarios where the decedent could lose homestead classification and therefore not qualify for the exclusion. There are many scenarios of ownership and this is only a partial list. Additional homestead classification information can be found in Minnesota Statute 273.124. Check with your county assessor for details specific to your situation.

<u>Scenario</u>	<u>Homestead Qualified</u>	<u>MN \$4 Million Exclusion Qualified</u>
Landowner lives on the land. Landowner farms the land.	Yes (Regular Ag) <sup>1</sup>	Yes
Landowner lives on the land. Landowner cash rents land to an unrelated tenant, crop-shares or custom farms the land.	Yes (Regular Ag) <sup>1</sup>	Yes
Landowner lives in town within 4 contiguous cities/townships or a combination thereof from the land. Landowner is actively engaged in farming the land.	Yes (Active Farming) <sup>2</sup>	Yes

**Scenario**

**Homestead Qualified**

**MN \$4 Million  
Exclusion Qualified**

Landowner lives in town within 4 contiguous cities/townships or a combination thereof from the land. Landowner's qualified family member<sup>4</sup> lives on the land and farms the land.

Yes (Ag-Relative)<sup>3</sup>

Yes

Landowner lives in town within 4 contiguous cities/townships or a combination thereof from the land. Landowner's qualified family member<sup>4</sup> does not live on the land but farms the land.

Yes (Active Farming)<sup>2</sup>

Yes

Landowner lives in town within 4 contiguous cities/townships or a combination thereof from the land. Landowner's qualified family member<sup>4</sup> lives on the land but does not farm the land. The land is cash rented to an unrelated non-family tenant.

Yes (Ag-Relative)<sup>3</sup>

Yes

Landowner lives in town within 4 contiguous cities/townships or a combination thereof from the land. Landowner's qualified family member<sup>4</sup> does not live on the land and does not farm the land. Landowner cash rents the land to an unrelated non-family tenant.

No

No

Landowner lives in town within 4 contiguous cities/townships or a combination thereof from the land. Landowner's qualified family member<sup>4</sup> does not live on the land and does not farm the land. Landowner crop-shares the land.

No

No

**Scenario**

**Homestead Qualified**

**MN \$4 Million  
Exclusion Qualified**

Landowner lives in town within 4 contiguous cities/townships or a combination thereof from the land. Landowner's qualified family member<sup>4</sup> does not live on the land and does not farm the land. Landowner custom farms the land.

No

No

Landowner lives in town but is not within 4 contiguous cities/townships or a combination thereof from the land.

No

No

Land is in an authorized entity<sup>5</sup>. Landowner is a member of the entity and lives on the land. Landowner is actively engaged in farming the land.

Yes (Active Farming)<sup>2</sup>

Yes

Land is in an authorized entity<sup>5</sup>. Landowner is a member of the entity and lives in town within 4 contiguous cities/townships or a combination thereof from the land. Landowner is actively engaged in farming the land.

Yes (Active Farming)<sup>2</sup>

Yes

Land is in an authorized entity<sup>5</sup>. Landowner is member of the entity but does not farm. Landowner a) lives on the land or b) lives in town within 4 contiguous cities/townships or a combination thereof from the land. Landowner cash rents the farm land to a qualified family member<sup>4</sup> who **is not** a member of the entity.

No

No

Land is in an authorized entity<sup>5</sup>. Landowner is member of the entity but does not farm. Landowner a) lives on the land or b) lives in town within 4 contiguous cities/townships or a combination thereof from the land. Landowner rents the land to a qualified family member<sup>4</sup> who **is** a member of the entity.

Yes (Active Farming)<sup>2</sup>

Yes

## Scenario

## Homestead Qualified

## MN \$4 Million Exclusion Qualified

Landowner lives on the farm and the farm land qualified for homestead classification. Landowner has to enter an assisted living, nursing home or other health care facility that is a) within 4 contiguous cities/townships or a combination thereof from the land or b) is not within 4 contiguous cities/townships or a combination thereof from the land<sup>6</sup>.

Yes (Regular Ag)<sup>1</sup>

Yes

Landowner lives on the land and farms the land. Landowner goes south each winter but Minnesota is their state of residence<sup>6</sup>.

Yes (Regular Ag)<sup>1</sup>

Yes

Landowner lives in town within 4 contiguous cities/townships or a combination thereof from the land and a qualified family member<sup>4</sup> farms the land. Landowner goes south each winter but Minnesota is their state of residence<sup>6</sup>.

Yes (Active Farming)<sup>2</sup>

Yes

## Land in Trust:<sup>7</sup>

Placing land in trust is a very common estate planning strategy. However, if not done properly this approach can cause challenges to maintaining homestead classification. The type of trust is not the current concern regarding homestead classification. Property can be placed in a testamentary, *inter vivos*, revocable, or irrevocable trust but regardless of type, the trust does not receive the homestead classification. For homestead purposes, trusts are considered entities, not individuals. It is the grantor (person establishing the trust) or individuals of specific relation to the grantor that may be eligible for homestead. The grantor of the trust is considered the owner for homestead classification purposes. Homestead is granted in the name of the qualifying occupant - trust grantor, grantor's surviving spouse, or qualified relative occupying the property. The individual also needs to be a Minnesota resident to qualify. In addition, these same rules apply to life estates and transfer upon death deeds.

### Owner-Occupied, Trust Held Homesteads:

Land held in a trust is eligible for homestead classification **if** the grantor or grantor's surviving spouse of the trust occupies and uses the property as a homestead. If the grantor passes away and the trust is not dissolved, the grantor's surviving spouse can occupy the property and it will continue to receive homestead classification. If the trust is dissolved, homestead classification will be based upon ownership and occupancy facts after the trust is dissolved.

### Relative Trust-Held Homesteads:

Property held in trust can receive relative homestead if it is occupied by a qualified relative of the grantor of the trust. The relative or surviving relative of the grantor must occupy and utilize the property as a homestead to qualify for homestead classification.

For agricultural property held in trust, a qualified relative includes a child, grandchild, sibling or parent of the grantor of the trust. Any of these individuals must be a Minnesota resident to qualify for the homestead classification.

### Linking Trust-Held Properties:

Property owned by different entities (trusts for example) **cannot** be linked or considered part of the same farm for homestead classification purposes. All property held in trust must have the same owner/ownership to qualify for homestead.

Here is an example of a married couple, each who have land in their respective trusts. Mr. A has a trust with land in it. He has homestead on the house, garage and one acre of land plus the additional farm land in his trust. Mrs. A has her own trust with additional and separate farm land as part of her trust. Since Mr. A already has the homestead classification, Mrs. A cannot link her land with Mr. A's land and get homestead classification on her acres as well. Only one individual in this case can receive homestead classification. If Mr. and Mrs. A were grantors of the same trust with all their land in that trust each with an undivided interest in the land, they would be considered joint owners of the trust and therefore all the land would be eligible for homestead classification. This also applies to an individual who owns land that is part of a partnership and owns additional land that is part of a corporation. These acres cannot be linked for homestead classification on all the acres collectively.

There are three exceptions to these rules as follows:

- 1) The homestead of a base parcel owned and occupied by an individual may be linked to a parcel of property that the owner owns with other individuals;
- 2) The homestead of a base parcel owned and occupied by an individual may be linked to a parcel of property that is owned by a trust and the individual owners of the parcel are the grantors of the trust-held property (and vice versa); and
- 3) In the case of married couples, properties that are held solely in the name of one spouse may be linked to parcels that are held solely by the other spouse and parcels that are titled in both names. This does not apply to any entities of which the husband and/or wife are both members. It only applies to parcels owned by natural people.<sup>7</sup>

If you change ownership of property from sole ownership to placing that property into a trust, you will lose homestead classification. However, homestead classification can be reinstated by simply completing the "Application for Homestead Classification for Property Held Under a Trust" and returning the form to your county assessor by December 15<sup>th</sup>. This is also the case for any "Special Agricultural (Actively Farming) Homestead" which includes land leased to an authorized entity, land owned by an authorized entity, property held in trust and leased to an authorized entity and land owned by an authorized entity and occupied by a qualified person. An authorized entity includes a family farm corporation, joint family farm venture, family farm limited liability company and a partnership which is operating the family farm.

As you can see, depending upon how land is held and owned, homestead classification can be a complex issue. Homestead classification is only one of many issues that need to be addressed when developing and implementing a farm business transition and associated personal estate plan. One small omission or incorrect selection can be costly. For clarification on homestead classification, it is best to visit with your county assessor for information specific to your situation. In addition, seek qualified professional legal help when engaged in the farm transition and estate planning, development and implementation process.

**Footnotes:**

<sup>1</sup> Regular Agricultural Homestead is a single, one-time application requirement until law changes. See MS.273.124, subd. 1(a).

<sup>2</sup> Active Farming Homestead is an annual application requirement. See MS.273.124, subd. 14(b), clause (i).

<sup>3</sup> Agricultural Relative Homestead is a single, one-time application requirement until law changes. See MS.273.124, subd. 1(d).

<sup>4</sup> Qualified family member includes landowner's spouse, landowner's or landowner's spouse's son, daughter, grandson, granddaughter, siblings, and parents.

<sup>5</sup> An "Authorized Entity" includes such things as a family farm corporation, joint family farm venture, family farm limited liability company, or a partnership which is operating a family farm. For information specific to your situation, see your county assessor.

<sup>6</sup> When entering a health care facility or traveling out of state for the winter, you can retain homestead classification. This is referred to under state law as a "temporary absence". If traveling out of state, Minnesota has to be your state of residence to maintain the homestead classification in Minnesota.

<sup>7</sup> Information source: Minnesota Department of Revenue Bulletin, "Trust properties and homestead determination", Information & Education Section, Property Tax Division, [www.revenue.state.mn.us](http://www.revenue.state.mn.us).

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