

ESTATE PLANNING PRINCIPLES

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Introduction:

Estate planning is the process of controlling your assets during your life as well as after 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. Life insurance amounts, policy ownership, and beneficiaries must be reviewed. Property ownership must be examined and tailored to your plan. Your will or revocable living trust must be adapted or changed to meet your objectives. Family income requirements must be matched with projected income. Other items to consider include fair treatment of heirs, passing on any business you may own to business heirs, tax minimization, administrative and probate cost savings.

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

Who Needs An Estate Plan?

Many people feel that estate planning is for the elderly or the rich or is not something they 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 children, it is crucial to have a will that designates guardians for those children in the event both parents are killed. 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 for them.

The bottom line is that 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. If they have no will, state law dictates how assets are transferred to the designated heirs.

Joint tenancy ownership is ownership between two people. They own the property together and upon the death of one joint tenant, the surviving joint tenant receives the decedent's property. To create joint tenancy, specific wording is necessary on the ownership documents. Typical wording is "John and Mary Doe, as joint tenants with rights of survivorship, not as tenants in common" for joint tenancies established after December 31, 1976.

Upon the death of one joint tenant, his/her portion of the property is included in the estate for estate valuation purposes. Joint tenancy property is not subject to the probate process. However, this is a complex area of tax law. Check with your attorney.

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 or by state law. At the time of death, the value of the decedent's portion of the property is included in his/her estate and is subject to the probate process.

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 in

his will to his children, but with a life estate (life use) to the wife, the children are the remaindermen 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.

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, 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.

Federal Gross Estate:

Estate taxes will be assessed on any estate that exceeds the Unified Estate and Gift Credit, referred to as the unified credit. This amount varies by year. The current amounts are listed in the following table by year:

2002-03	\$1,000,000
2004-05	\$1,500,000
2006-08	\$2,000,000
2009	\$3,000,000
2010	No limit
2011	\$675,000 – if no legislative action

An individual’s Federal Gross Estate includes all

property held at death. It will include all stocks, bonds, cash, land, machinery and 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 gross estate. Those include debts owed by the decedent, funeral costs, administrative costs and last medical costs can be subtracted from the gross estate. Some examples of those deductions follow:

1) Marital Deduction:

A married person can pass any amount of estate assets to their spouse, free of any estate tax. 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 would will up to \$1,000,000 (2003) to other heirs, with the balance going to their surviving spouse using the marital deduction.

Example: Wife dies in 2003 leaving a total estate of \$1.75 million. If she willed \$750,000 to her children and \$1.0 million to her husband, no estate taxes would be paid upon her death. The surviving husband (not remarried) may or may not have an estate tax problem depending upon the value of his estate at the time of his death. Since he has no spouse on which to use a marital deduction, he is limited to the unified credit amount in effect the year of his death.

2) Charitable Deduction:

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

Federal Estate Tax Calculations (Simplified):

Assume a husband dies in 2003 leaving a gross estate of \$1,400,000. He has estate settlement costs of \$30,000, debt of \$100,000, a marital deduction of \$800,000 and a charitable deduction of \$50,000.

Calculation:

Gross Estate	\$1,400,000
Debt	- 100,000
Deductions	- 30,000
Charitable deductions	- 50,000
Marital Deductions	- 800,000
Adjusted Taxable Estate	\$ 420,000

Since the taxable estate is under \$1,000,000 (2003), there is no estate tax due.

Federal Estate Tax Rates:

For taxable estates over \$1,000,000 (2003), the tax rate is 49%. That rate changes as follows:

2004 – 48%	2005 – 47%
2006 – 46%	2007 – 45%
2008 – 45%	2009 – 45%

In 2010 the estate tax is eliminated and only the gift tax of 45% remains. In 2011, the rules revert back to the 2001 rules if there is no legislative action taken.

State Estate Tax:

In addition to federal estate taxes, there are some states that have estate taxes as well. Most states with estate tax provisions did not raise their exemption amounts to match the federal increase. For Minnesota, the exemption amounts are as follows:

2003 - \$700,000
2004 - \$850,000
2005 - \$950,000
2006 and beyond - \$1,000,000

Consult with your accountant or attorney regarding the state estate tax issues as they relate to your situation.

Special Use Valuation (SUV):

Farmland is one asset that 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 by taking the land rental rate for comparable land minus the real estate taxes paid, divided by the AgStar average annual effective interest rate.

Example: land is appraised at \$2,150 (FMV) per acre with real estate taxes of \$20 per acre, cash rent of \$130 per acre, and an AgStar effective interest rate of 9 percent. The SUV calculation is as follows:

$$\frac{\$130 \text{ rent} - \$20 \text{ RE tax}}{.09 \text{ AgStar interest}} = \frac{\$110}{.09} = \$1,222/\text{acre}$$

Using the SUV on this land could save estate taxes on \$928/acre. **Note:** 1) SUV should not be used on estates that are less than the unified credit 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.

Family Owned Business Exclusion:

The Family Owned Business Exclusion (FOBE) was enacted in 1997. It allows owners of family owned farms and businesses a larger exemption from estate

taxes. If your assets at death qualify for this exemption, you can have an estate of \$1.3 million (rather than the \$1.0 million in 2003) and pay no estate taxes. To qualify, the decedent must:

1. Have been a U.S. citizen.
2. Have business property which exceeds 50% of the adjusted gross estate.
3. Must have owned and materially participated in the family business (this requirement could also be met by a member of the decedent’s family).
4. Pass or sell the property to a qualified heir.

The qualified heir must continue to materially participate and continue to own the qualified property for 10 years following the death of the decedent.

The FOBE became effective 12/21/97 and was modified in 1998 by Congress. It ends in 2003 because of unified credit increases to \$1,500,000 in 2004-2005. It is a highly complex tax law with many areas of uncertainty. Check with your attorney if you choose to use this provision.

Other Considerations:

1) Power-of-Attorney - adding a provision in your will granting someone Power-of-Attorney in the event you are incapable of making financial decisions is a good idea. The individual or individuals can manage your assets in your best interest if you are unable to do so.

2) Health Care Directive – writing and attaching a Health Care Directive to your will ensures your wishes for health care are honored in the event you are incapable of expressing your wishes. You decide what level of health care you want in a given situation and place those wishes in effect via the Health Care Directive. Many hospitals and health care providers have information on developing the care directive as well as forms to complete.

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ESTABLISHING A WILL

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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. In addition, provisions in your will can establish guidelines for the care of your surviving spouse and/or children. A will is crucial to your estate planning process. Your will is usually the primary vehicle used to carry out your wishes regarding the management and distribution of your estate/assets.

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 expense of having an attorney draft your will is minimal compared to the potential tax liability and other expenses that can be incurred if an error is made.

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 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.

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

heir if assets are equally divided between the heirs. The state plan also lets a judge decide on guardians for minor children and caretakers for your property. A will effectively lists your wishes and establishes procedure for how your estate is managed and distributed.

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 for minor children. The individuals you select for guardians should be consulted in advance and asked if they would be willing to care for your children in the event of your death. Their care would include day-to-day physical care as well as management of their financial affairs. You can name separate guardians for their care and financial matters.

Another article names an executor or personal representative to manage and handle the administration of your estate and supervise the distribution of your assets. 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. Executors are usually paid 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.

Signatures and witness signatures are an important part of every will. It affirms the fact that you personally executed the will and that the document lists your wishes and directives.

Most wills give special mention of the spouse. You cannot completely disinherit a spouse unless a valid prenuptial agreement has been previously executed.

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 for buying out other 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:

A simple will directs 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 if they have minor children. As families and finances grow and there is a need to protect the children further, a more complex will may be required.

Complex wills usually create one or more of the following provisions:

1. A trust for minor children which provides a manager or ‘trustee’ of assets designated to the children. The trustee will care for and manage the children’s property. They will attend to the financial care of the children and finally distribute the property according to your direction.
2. A marital trust can provide a spouse with management help for any assets. A “trustee” is named to manage the marital trust.
3. A credit shelter trust can be used to reduce estate taxes since designated assets put into this trust are kept out of the spouse’s estate. The surviving spouse receives the income from the credit trust but has no management control. Assets in a credit trust pass to children at the spouse’s death. Your designated “trustee” or “co-trustees” manage the property until the trust is terminated.
4. A granted life estate operates much like the credit trust, except that the spouse must manage the assets until death when it passes to the children. In a life estate, the spouse has control of the property and receives all net income from the property. The spouse, however, cannot independently sell the property. Establishing a

life estate can be a complicated process if the family wishes to dispose of life estate assets during the spouse’s lifetime. It requires a sign-off of all affected heirs to accomplish a sale or to make major changes in the property.

Other provisions are possible and should be reviewed with your attorney.

After You Have Written Your Will:

Keep it in a safe place – your safe, a safe deposit box or your attorney’s office safe all provide secure storage. 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
- death of spouse
- birth of children\inherited property
- estate growth
- estate law changes
- divorce
- health status changes
- move to another state
- 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. Perhaps you should make multiple copies of this document and distribute it so everyone affected knows the situation.

Living Will:

You may wish to consider drafting, in addition to your regular will, a “living will”. It gives instructions as to how you personally wish to be cared for should you become terminally ill. It tells others (family or judge) your wishes regarding the extent of medical care you desire.

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DISTRIBUTION OF ESTATE ASSETS

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Basic Estate Distribution Plans:

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

No Plan:

A common plan, (but not recommended), is to "not plan" your estate. No will is written and little attention is paid to property ownership, estate distribution, or taxes. If you have no will, state law will determine who will inherit your property. In most cases it will be divided in some manner between your spouse and children, except for joint tenancy property and life insurance. Joint tenancy property will go to the surviving joint tenant and life insurance will go to the named beneficiary. See Estate Planning Series #2 entitled *Establishing A Will*.

Joint Tenancy Distribution:

Another common plan is to put all property into joint tenancy and to let the survivor inherit all the property. This may work well in small estates where husband and wife hold all their property in joint tenancy. Holding property in joint tenancy with children, however, can be a problem if the child dies first or if the child gets involved in bankruptcy, divorce or other adverse legal action. Many couples use joint tenancy ownership of the personal residence, personal vehicles and the checking account. When one spouse dies the survivor gets the property without delay. A joint tenancy plan can work well for families with total net estates under the unified credit amount.

Example:

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

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

"I Love You" Will:

Many wills are written which distribute all assets to the spouse. Sometimes these are called "I Love You" wills. This can be a good plan if the total value of the couples assets, including life insurance, is under the unified credit amount of \$1,000,000 (2003) and no estate taxes would be payable on the second death. Most of these wills leave everything to the children equally if there is no surviving spouse. A joint tenancy distribution or a simple will, leaving everything to the spouse, gives no protection to your children. Your surviving spouse may spend or lose all the property or may remarry and lose control of your assets, leaving your children with no part of your estate.

Complex Will:

Couples who have divided their property ownership somewhat equally between themselves often use complex wills. This plan uses a will to direct property, usually real estate (except the personal residence), to the children with life use to the spouse. This is used when combined estates are valued over the unified credit amount of \$1,000,000 (2003) and when definite provisions wish to be made for the children. Any assets such as stocks, bonds, life insurance proceeds, mutual funds, real estate or cash can be set aside for the children. Wiling a portion of the estate to the children, protects the children in case the spouse remarries or otherwise consumes the estate prior to death. It also prevents this portion of the estate from being taxed at the death of the spouse.

Example:

John and Mary each have \$1,000,000 of assets, plus a

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

Revocable Living Trust:

Many couples today use the revocable living trust (RLT) as their primary estate plan. They choose a RLT because assets in an RLT pass outside the probate process, potentially saving thousands of dollars. They set up joint or separate revocable living trusts during their lifetime by placing all their assets into the trust. They designate trustees, beneficiaries and all terms of operation and distribution for the trust. People usually designate themselves as trustees until death or incapacity when successor trustees take over. Trustees should be trustworthy people or institutions that can make decisions and competently comply with trust directives. Trustees should be informed of their position and made aware of your wishes.

Beneficiaries usually include yourself or your spouse as long as you live. After your deaths, you must designate who will get the annual income as well as the final trust distributions.

A RLT can be changed, modified, or discontinued at any time. It is completely flexible and adjustable. The terms of the trust should be very carefully constructed. Consideration should be given to as many contingencies as possible. Be sure to cover items like early death of children, divorce of any of those involved, protection of farm/business heirs, an option to buy provision for farm/business heirs, division of assets to farm/business and other heirs, and asset valuation changes.

When a RLT is set up, a companion "pour over will" should also be placed into effect, which will place all assets not presently in the RLT into the RLT at death,

thus managing the entire estate through the RLT. The RLT offers the advantage of privacy. A will is a public document open to inspection by anyone, whereas an RLT is not. See Estate Planning Series #6 entitled *Revocable Living Trust*.

Irrevocable Living Trust:

An irrevocable trust is a trust established during your lifetime to save death (estate) taxes and/or to establish a trust for beneficiaries. It removes property, irrevocably, from your asset list and hence your gross estate. Putting assets in an irrevocable trust is final. Assets cannot be reclaimed or the trust conditions modified once established. Assets placed in an irrevocable trust for the benefit of others, with no retained decision making power or right to income to the grantor, would not be included in the grantor's estate.

There are many other plans that are used by people to plan their estates. Most plans for larger estates are very complex and all plans require the aid of a legal specialist. For more information, see Estate Planning Series #5 entitled *Trusts: Definitions, Types, & Taxation*. After studying this basic educational material, contact your attorney for further information.

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GIFTING ASSETS

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Introduction:

Gifts to others can be a valuable tool in estate planning. It can be used to:

- Reduce your taxable estate
- Transfer tax obligations to your children
- Provide for a favored charity
- Provide help to others who are deserving

Basically, anything you own can be gifted to others. Stocks, bonds, cash, antiques, farmland or a house can be gifted to others if you wish. The Internal Revenue Service allows you to give away a certain amount of property without any gift tax or gift tax reporting. Federal law allows each person to give away up to \$11,000 per year to as many people as they wish, free of any gift tax. A couple can jointly give away assets and can give up to \$22,000 per donee per year. However, if they together make a gift to a single donee of more than \$11,000, but \$22,000 or less, of assets belonging to only one of the spouses, they can still avoid gift taxes, however, they are required to report the gift as a "split gift" on Form 709, U.S. Gift Tax Return.

Example: John and his wife, Mary, each have estates. John's estate is currently valued at \$1,120,000; Mary's is \$1,000,000. They decide to give gifts to their children to reduce John's estate to a level where it will not be subject to tax if passed on to the children through his estate. In 2003, John and Mary jointly give away John's property with a value of \$22,000 to each of three children (\$66,000), reducing his estate to \$1,054,000. In 2004, they give \$22,000 again to each child to reduce the estate to \$988,000. There would be no gift tax on any of the gifts, but they would be considered "split gifts," and would need to be reported on Form 709.

Gifts are always valued at fair market value (FMV). The couple the example could have given \$22,000 in cash, \$22,000 worth of stock, real estate, or a combination of items to their children. As long as the FMV of the property gifted is under \$22,000 per year per person, no gift taxes will be imposed.

You can give unlimited gifts to your spouse or to a charity in any year with no gift tax consequences. Currently, every person has a lifetime unified credit with the Internal Revenue Service that will offset gifts of up to \$1,000,000 (2003). Gifts given in excess of the annual exclusion (\$11,000) reduce the lifetime \$1,000,000 exempted amount. See Estate Planning Series #1 entitled *Estate Planning Principles*.

Example: Pearl gave \$51,000 to her son, Pete, in 2003. After subtracting the \$11,000 annual exclusion, a possibly taxable gift of \$40,000 remained. The \$40,000 is subtracted from her \$1,000,000 unified credit amount, leaving \$960,000 of the credit to be used for future gifts or at the time of her death. No gift tax is payable until the total unified credit amount is used up. However, a gift tax return (Form 709) must be filed on gifts to any individual, other than your spouse, when the gift exceeds the annual \$11,000 exclusion. Be careful not to get caught on a technicality. If you give an \$11,000 gift and later in the year give a \$100 birthday gift to the same individual, technically you have exceeded the \$11,000 allowable gift and may be required to file a gift tax return.

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 basis

(original cost) of the gift remains that of the donor. When the recipient sells the property, they will generally pay income tax on the difference between the sale price and the donor's basis.

Gifts of 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. 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. The expenses of raising the grain are deducted on the parent's tax return. 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 possibly lower tax rate and 2) no one pays the 15.3% SE tax on the grain sale. Be careful when gifting grain to children under 14. There are limitations on the amount of 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.

Documenting Gifts:

When gifting items like stock, machinery, livestock, land or vehicles, it is important to document the gift. To document a gift, state in writing that a gift was made. Both parties should sign and date the document and the document should be notarized. If the gifted property is a titled asset like 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.

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.

Gifts of Land:

You can gift land by deeding over actual acres. For example, you may 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 and Mary (together or separately). This method may require less legal work. A "limited partnership" can also be used to gift land.

Gifts of Contract for Deed Payments:

If you wish to forgive debt payments from your child, 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 children not having complete evidence of having paid for the property. You must declare payments received on a contract on your tax return. These payments must be declared, even if you forgive the payment.

Charitable Giving:

Some people prefer to give to their favorite charity or religious organization. Doing so devotes your money to the greater good of mankind and can provide you with an income tax deduction. If you have appreciated property and wish to give it away while maintaining an income stream and also getting a tax deduction, you might investigate a charitable trust. A charitable remainder trust allows you to receive an income stream from the donated asset, with the remainder going to charity.

Can You Afford It?

Gifting is 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.

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TRUSTS: Definitions, Types, and Taxation

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What Is A Trust?

A trust can provide a means to hold and manage property. It can be custom designed for your situation. A trust is usually established to empower someone else (trustee) to manage and care for your property for the benefit of your family (beneficiaries).

A trust must have three elements: (1) property, (2) a trustee and (3) beneficiaries.

Any type of property such as cash, personal property or real estate, can be placed in a trust. The decision as to which assets you place in trust will depend upon your overall plan and objectives. Transferring assets to a trust is a formal process and title assets must be changed from individual ownership to trust ownership.

The trustee is the individual or individuals, bank, or trust company you name as caretaker of the trust. The trustee holds and manages the property in accordance with the guidelines in the trust instrument. The trustee is usually paid for their services. However, family trustees often serve without compensation. A trustee should be someone you trust to serve well after you are gone. They should be astute in business matters and have high ethics.

The beneficiaries are the people for whom the property is managed. They 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 so all contingencies that could arise, regarding you or your beneficiaries, are covered. The trust instrument is a complete set of guidelines for

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 and 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 of the individual setting up the trust (grantor).

Trusts are used mainly to manage property for minors, elderly persons, and handicapped people. 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. Perhaps a wife may wish to leave a life estate in certain property to her husband with eventual ownership going to her children. Trusts can also be setup to reduce the size of an estate or cut estate and probate costs.

Types of Trusts:

There are two types of trusts, living trusts and testamentary trusts.

Living trusts are set up during the grantor's lifetime and may continue after death. A living trust can be either a revocable trust (changeable anytime) or an irrevocable trust (once established cannot be revoked or changed). 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 probate process. A living trust can be useful in providing management through a trustee for older family members as they advance in age.

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). 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. The RLT is used often. See Estate Planning Series # 6 entitled *Revocable Living Trust*.

Irrevocable living trusts are designed mainly to save estate taxes. If the grantor is not the trustee or beneficiary and has no control over the trust assets or their ultimate disposition, the trust assets will generally not be included in the grantor's estate. Irrevocable trusts may also reduce probate costs since assets put into it are treated as a gift and are removed from the estate of the grantor. Creating an irrevocable trust may have gift tax ramifications if the gift exceeds the annually allowed gift amounts.

A testamentary trust is set up in a will and becomes effective at death. These trusts do not save probate fees or estate taxes. The main purpose of testamentary trusts is to reduce estate taxes but preserve income to the surviving spouse by passing assets to children in a "credit shelter trust," or to establish a "marital deduction" trust for the surviving spouse.

A charitable remainder trust (CRT) can be established to transfer assets to a charity yet retain an income stream during your and your spouse's lifetime. At 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.

Example: Tom and Mary set up a Charitable Remainder Trust for their church and gift to the trust farmland worth \$100,000. In exchange they receive a \$5000 annual lifetime payment for 20 years. The church may collect the rents from the farm or sell it and invest the proceeds. At the end of the 20-year period, the church gets the farmland or the proceeds of the sale, and is released from any further obligation. Tom and Mary get a tax deduction in the initial year of the gift. The amount will depend on the value of the remainder interest.

There are several other trusts that may be useful in estate planning. The life insurance trust, the generation skipping trust, and others may offer possibilities for estate planning. Before choosing a 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 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.

Current tax rates are:

<u>Tax Rate</u>	<u>Income</u>
15%	\$ 0-1,850
27%	\$1,850-4,400
30%	\$ 4,400-6,750
35%	\$ 6,750-9,200
38.6%	over \$9,200

Most trusts distribute all income to avoid the high taxation rates. However, if all income from a revocable living trust goes to the grantor, and if the grantor is also the trustee, no additional income tax forms are required. All income from the revocable living trust 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.

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REVOCABLE LIVING TRUST

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11/2003

Revocable Living Trust:

The Revocable Living Trust (RLT) has some distinct advantages over a will for use in estate planning. Though these trusts have been available for years, they are enjoying renewed popularity because they can save probate costs.

Trusts established during a person's life are called living trusts. They can be revocable or irrevocable. The revocable trust can be amended or discontinued at any time. An irrevocable trust cannot be modified or discontinued once established.

Individuals who use the revocable living trust 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).

To set up a living trust, 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 revocable living trust does not constitute a gift, so there are no gift tax consequences. Once established, everything transferred to the trust then belongs to the trust. As trustee, you maintain control. You can buy and sell trust assets, and even give them away.

Positive Aspects to Using the Revocable Living Trust:

- RLT assets are not subject to the probate process, so your heirs may save

considerable estate settlement and probate costs. You may be able to avoid attorney and court costs associated with taking inventory, distributing assets and court costs. The transfer may also be speedier. But a relatively large part of the 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 revocable living trust will avoid heirs having to disclose your holdings in the public probate process. A living trust 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 in during the grantor's declining years when they may not be able to physically or mentally manage their property. A successor trustee is named in the trust document that can manage, invest, sell, and liquidate your assets. Select a successor 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. A successor trustee is usually compensated for services rendered.
- If you die and own property in more than one state, your will must be probated in each state in which you own property, requiring much more time and expense.

This will not be the case if you have an RLT.

- A revocable living trust can provide an excellent vehicle to allow a farming heir the opportunity to gradually buy into the farm business. Provisions can be written into the RLT, which allow the farming heir the right to purchase machinery, breeding stock 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 workable.

Example: Sue set up an 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 carry a 5% interest rate. She also gave Sam the right to rent the land from the RLT for 5 years following her death at a rate of \$90.00 per acre. The RLT document also gave Sam the right to purchase any portion of her land at any time during this five-year period at appraised 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.

Disadvantages of the Revocable Living Trust:

- You do not save federal estate taxes or state inheritance taxes. IRS views you as full owner of any property held in a revocable living trust. Consequently, assets in your trust **do** receive a stepped up tax basis at your death. Heirs can immediately sell the property if desired for little or no income tax gain or loss.
- 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.

- If you transfer your property to a trust, the annual Section 179 depreciation deduction cannot be used on your tax return. Instead, all capital items must be depreciated.

Setting up a Revocable Living Trust:

The drafting of the trust document is a very important function. It should include all your wishes regarding distribution of your property. Attorney fees for setting up an RLT will generally be higher than for writing a will. Much lower estate settlement fees and elimination of probate fees usually offset higher initial costs.

It is important to formally transfer all assets to the trust. This can be a time consuming task. 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 individual 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 an RLT will also need a "pour over" will. The pour over will transfers any individually owned assets into the trust not previously transferred.

There is no perfect solution to every transfer or estate situation. If you decide to use an RLT, find an attorney who is well versed in drafting living trusts.

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INCOME TAX ISSUES FOR ESTATE PLANNING

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Erlin Weness, Professor Emeritus

11/2003

Introduction:

Some of the most costly mistakes in estate planning occur when income 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 income 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 the income tax basis (original cost) of the asset.

Example: If you sell land for \$100,000 and your income tax (or cost) basis for the land is \$20,000, your taxable gain is \$80,000.

Income tax 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 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 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 inherited some land from your mother that was valued in her estate at \$160,000. Your tax basis is \$160,000. If you sell it for \$160,000 you have no capital gains tax.

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 \$160,000 but having a basis (donor's purchase price),

\$25,000. Your basis is also \$25,000. If you sell it for \$160,000, you have a \$135,000 taxable capital gain.

Asset basis is extremely important to property holders because it determines the amount of income tax they will pay on the sale of the asset. Assets that are inherited and pass through an estate receive a new "stepped up" basis. The stepped up basis is usually the fair market value 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 300 acres of farmland for \$1,500 per acre or \$450,000. It had a tax basis of \$100,000. Her taxable gain (whether sold for cash or by installment method) is \$350,000. Because of the sale, either she or her heirs must pay income tax on the \$350,000. Capital gain taxes at a 15% tax rate would be \$52,500. If, however, Sally retained the property until her death, the estate would assign a stepped up basis of \$450,000 (FMV). The heirs could later sell the property for that amount and pay no income tax. Total income taxes saved by keeping the property until death and passing it through the estate would be \$52,500.

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. 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 must continue to pay the income taxes on principal and interest payments as they receive them.

Example: You own 100 acres of land worth \$100,000. You have a basis (purchase cost) of

\$10,000 in the land. At age 85 you sell the land to your son for \$100,000 on an installment contract payable over 20 years. Your profit ratio on the amount of each principal payment, which is taxable, is 90% ($\$90,000 \text{ profit} \div \$100,000 \text{ sale price} = 90\%$). You receive principal payments of \$5,000 each year for 4 years. Each year you include 90% of \$5,000 or \$4,500 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 son. Your two daughters will continue to receive 2/3 of the \$5,000 annually and must include 90% of the amount on their tax return for the remaining 16 years. They will each receive \$26,666 in principal payments and will have to pay income taxes on \$23,999 of it (90%). The son who holds the contract, inherits the entire \$26,666 in the year of death. The 90% or \$23,999 is taxable income to him in the year of your death.

If you and your children must pay taxes at a capital gain rate of 15%, a total of \$13,500 tax will be paid on this contract over the years.

If you had kept the property in your estate and not sold it, it would have passed to your children valued at \$100,000 (stepped up basis) and they would owe no income taxes if they sold the property for that value.

Selling on an installment sale late in life, cost this family \$13,500 in unnecessary income taxes.

House:

If you sell your farm, which includes your personal residence, parcel 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 of gain (\$500,000 for joint filers). You must have owned your home and lived in it for a period of two of the prior five years before the sale. You need not buy a replacement home to qualify for this tax exemption.

If you sold your home prior to May 6, 1997, different, more restrictive rules apply.

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

Tax Free Exchange:

Selling property outright will cause a taxable event. If you have improved land or buildings, a like-kind tax free exchange, known as a 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 and leave the older generation with more remote, low maintenance farmland. Using the tax-free exchange can avoid or postpone taxation of the parent's capital gains on low basis property.

Income Averaging:

Beginning Jan. 1, 1998, qualifying farmers are 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.

Spread Out Income:

In most cases, as a farmer retires and they sell off their farm business assets, a large income and self-employment tax bill emerges. 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:

Capital assets held over 12 months generally qualify for lower tax rates. For sales after May 5, 2003, federal capital gains tax rates are 5% for taxable incomes under about \$56,800(MFJ) and 15% for taxable incomes over \$56,800(MFJ). Minnesota adds a 5.35-7.85% tax on capital gains. Overall capital gains rates are from 5 to 20% less than tax rates on ordinary income.

Tax Code Complexity:

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

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LIFE INSURANCE IN ESTATE PLANNING

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11/2003

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 families 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 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 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 with pure 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.
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 willed to the off-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 death taxes, estate settlement costs or debt obligations of the deceased.
5. Insurance can be purchased by a farming heir/heirs on his/her 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. **Note:** a critical factor here is that the farm or business heir own the policy and make 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 an estate if none exists. It can be an estate building plan providing money to heirs.

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. A change in ownership of a life insurance policy is a complex matter. One should review ownership provisions with an expert estate planner.

For example, even though you transfer ownership of a life insurance policy within 3 years of death, the benefits will most likely be included in the estate of the original owner. In addition the new owner can change 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 determines the distribution. The death benefits will probably be included in your gross estate which may trigger estate taxes.

Most husbands designate their wife 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.

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.

Key factors in deciding how and when to use life insurance as well as how much to purchase involves affordability, age, insurability, size and composition of family and estate, projected risk and family need.

Carefully analyze these factors before getting involved with life insurance. Life insurance, if purchased, must be included as part of your overall estate plan. Continue to evaluate your life insurance as family and estate needs change throughout your lifetime.

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DISPOSING OF PERSONAL & HOUSEHOLD ITEMS

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11/2003

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 nursing home 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 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.

Shall I give away things now or let my executor divide it 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 house or apartment. This can simplify your life as well as that of your personal representative 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 and friends? I only have one antique grandfather clock.

Fairness to children is difficult, if not impossible to achieve. Sometimes, knowing your children's likes or dislikes and their interests can give you some

guidance when distributing assets. If you have a relative who is particularly interested in family history, 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, it may be wise to give that antique grandfather clock to one child, but let the others have offsetting items like your car or several major appliances or antiques.

Another approach may be to hold a family auction and sell the outstanding item or items on bid to anyone in the family. This gives equal access to all family members. Once complete, you can then split the proceeds among the other family members.

What are some ways I or my executor can divide possessions fairly and more or less equally?

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

1. Hold a family auction. Allow family members to buy items in open bidding. You can keep the money generated or divide it equally among family members.
2. Draw straws for position. The first person chooses an item, person #2 picks an item, then #3. When the final person has selected, #1 again chooses an item. The rotation of choosing continues until all items are gone.
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. Place your possessions into groups of items having approximately equal value. 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.
5. 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.
 6. Another approach is to call the family together and go around the house and ask who might like to have a given item. There may 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 treated fairly in the process.
 7. 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 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, and current leases.
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 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. Make 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 video tape you 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. In the letter, describe each item and who you want to receive it. It is probably best to have several copies of this letter in the hands of your family members or in your attorney’s possession. It is then readily available when your will is read. Your will 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.

Disposing of prized possessions can evoke feelings of sadness and loss **or** it can mean satisfaction. 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.

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

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STEPS IN ESTATE SETTLEMENT

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11/2003

Introduction:

The decedent's will dictates how their assets will be distributed. If the decedent has no will, referred to as "dying intestate", the state of residence 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. If property is held "Tenancy In Common", it is subject to the probate process.

The probate process in the United States is designed to expediently and efficiently 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 executor or personal representative that will represent 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. Those steps are outlined in this information piece.

Locating the 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 an executor or personal representative who will be in charge of the settlement process. If the will is not found in the home, it most likely is in the safe or safe deposit box. Locating the key or combination is a first order of business. If no will can be located, you might check with the personal attorney of the deceased to see if he/she has a copy of the will. Locating the most current will 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 estates. 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. Some attorneys work for a percentage of the net estate and some work at an hourly rate.

Secure Copies of the Death Certificate:

The personal representative will need several copies of the official death certificate. 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:

One of the first steps 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 may 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 appointed personal representative or executor is required to keep accurate records of all estate income and expenses. The executor should open an estate checking account or continue to use the checking account of the deceased. **Under no circumstances** should the personal representative mix his/her personal funds with estate funds, nor should he/she pay any bills in cash. The personal representative should keep all checks and receipts. 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 is charged with paying all lawful claims of creditors and paying the bills of the deceased. These bills include medical expenses, funeral, and other outstanding business and personal bills.

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 should pay attention to income tax and estate tax possibilities. The attorney or 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 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 for the personal representative to inform 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 involving them.

Convert Assets to Cash:

Unless the will advises 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 calls for direct distribution of assets to certain heirs, assets would be held until the date of distribution.

Distribution of Assets:

One of the final steps is to distribute all assets to the rightful heirs according to the will, testamentary trust agreement, or state intestate laws. Legal transfer is made of non-cash items and checks are written to heirs. A prudent personal representative 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 may have to file income tax returns for the decedent as well as estate tax returns. It is best to find out the 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 include newspaper notifications, formal appointment of the personal representative, notification of heirs, determination and payment of personal representative fee, closing of all accounts, and formal closing of the estate. The attorney will advise the family or personal representative as to these details as the process proceeds.

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