Trusts:
Resources to help our next generation of farmers

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A ***trust*** is a legal entity that separates the management of property from the enjoyment of property. A settlor, the creator of a trust, transfers title of his or her assets into the name of the trust; this is called funding the trust. This property, which is held in trust, is called corpus, principal, or the trust estate. A trust instrument is the set of documents creating and detailing the terms of the trust. The instrument names a trustee to manage the trust property, and sometimes a backup trustee as well. It also names the beneficiaries who will receive proceeds from the trust during the life of the trust and the beneficiaries who will receive the corpus when the trust is dissolved.

Reasons for establishing trusts include: to avoid or minimize probate costs, guard against will contests, protect privacy in property transfers, protect assets from beneficiaries, allow for someone else to manage your property when you no longer wish to or are no longer able to, allow someone else to manage property for minors, and, in limited cases, save estate tax. Trust options today are limited only by the creativity of the settlors and may serve very different purposes depending on the terms. Outlined below are several of the more common types of trusts.

A ***revocable living trust*** is created by the settlor during his/her lifetime, and the settlor retains the power to destroy (revoke) the trust at any time during his/her life. Only at the death of the settlor does the trust become permanent (irrevocable).

A revocable living trust is sometimes referred to as a substitute for a will because its main purpose is to avoid probate of trust assets. Probate is avoided because the assets are no longer property of the deceased, but are owned by the trust, even though the deceased may have been both the trustee and the beneficiary. These trusts are particularly useful when property is held in several states and therefore would have to be probated in each respective state.

Although probate costs are avoided, trusts cost more to create than a will because they are much more complicated to draft and fees may be associated with changing the title of assets. In addition to avoiding probate, trusts are less susceptible to attack than a will, because the trust has been in existence for some time before death. The court accepts the fact that the settlor could have changed the terms of the trust during their lifetime as proof that the trust will operate in accordance to their wishes.

Because the settlor retains control of the assets during life (settlor retains the power to revoke the trust and have the property returned), the property remains part of the taxable estate. Revocable living trusts are not useful for reducing the value of the estate for estate tax planning purposes, except for enabling spouses to split their estates to keep the value of their separate estates under the applicable exclusion. Heirs do receive a step-up in basis.

Revocable living trusts should be used in conjunction with a ***pour over will***. Because a will directs the court how to dispose of your assets at death, this provision will act as a catch-all and will direct property still titled under your name to "pour" into the trust.

An irrevocable ***inter vivos trust*** is a trust created during life that cannot be terminated once created. If created and managed correctly, these trusts can reduce the value of the taxable estate. The property will not be included in the value of the settlor's estate only if the settlor has permanently forfeited the property. Therefore, the settlor must not retain interest in the income or corpus of the trust; it must benefit others. Also, the settlor cannot retain the power to change or transfer the property, or the property will be included in the settlor's taxable estate.

Transferring property into an irrevocable trust is essentially a gift to the beneficiaries and transfers will be subject to gift tax. Annual amounts of over

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$12,000 transferred into the trust will be subject to gift tax. An election can be made to transfer up to $1 million into the trust without paying gift tax; however, the transfer will reduce the unified credit and increase the amount of your estate that will be subject to estate tax. For very large estates, it may be valuable to make the election so that property appreciates in the trust instead of in the estate. Since the property must be forfeited by the settlor, the beneficiaries must have a present interest in the trust property.

Other types of trusts include testamentary or pour over trusts which are established by will. ***Spendthrift trusts*** protect assets that may be recklessly spent by beneficiaries, by limiting the rights of the beneficiary to receive income from the trust. ***QTIP trusts*** provide a surviving spouse income during his or her lifetime. Charitable remainder trusts allow the settlor to contribute his/her property to charity and receive the income from the property over his/her lifetime.

Consequences of creating a trust including managerial capabilities, tax advantages and disadvantages, and revocability will vary greatly depending your specific circumstances. Consult with your attorney for more details.