

Estate Planning BULLETIN

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When planning for the distribution of your assets, the options can seem overwhelming. Even if you know you want your property to pass solely to immediate family members,

accomplishing that result is not always as simple as it sounds, particularly when real property is involved. The creation of a trust can be appropriate for many people with a variety of asset types. Reasons to consider a trust include the avoidance of probate, reduction of taxes, protection of assets, and prevention of stressful and burdensome proceedings after one's passing. While there is one specific type of trust that is commonly referred to as a "Family Trust" there are several types of trusts that can be set up with the primary goal of benefiting family members. The appropriateness of a trust depends on the specific facts and circumstances of the person holding the assets, and the family in general.

What is a trust?

A trust is a legal arrangement that involves one person, the trustee, holding and managing assets on behalf of someone else, the beneficiary. The person who forms the trust is called the settlor or grantor. A trust involves three essential pieces: (1) a trustee who holds the trust property and has certain duties to manage it; (2) beneficiaries, who receive benefit from the trust; and (3) trust property. Property in trust can include real estate, cash, income from a family business, and more.

A trust can be created during the testator's lifetime (intervivos or living trust), or created in a will (testamentary trust). The agreement that sets up a living trust can be revocable (changeable) or irrevocable (permanent).

The general advantage of trusts is that they allow the settlor to determine who receives the benefit of the property held in trust, when they receive it, and under what conditions. Circumstances

that could indicate that a trust is appropriate are: (1) if the settlor's spouse is unwilling or unable to manage assets after the settlor's passing; (2) if the settlor's children are minors or unable to handle money responsibly; or (3) if a beneficiary is disabled. Trusts are also a popular way to provide for the future educational or medical needs of surviving spouses or children.

The Basic "Family Trust"

The majority of estate plans involve creating a trust in your will so that assets can be managed for the family members you have chosen to receive benefits, particularly for your children. The testamentary trust is part of the will so it becomes effective only upon the death of its settlor, and can be changed at any time prior to death. The will designates the property to be placed into the trust, the circumstances under which the trust income or principal will be distributed, and the person or entity who will be the trustee.

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Trusts *for the Disabled*



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Properly established trusts can shelter (exclude) the assets held by the trust for purposes of eligibility for government assistance programs such as Medical Assistance. There are basically two such types of trusts for disabled persons. The first is established with funds of the disabled person or their spouse, or under court approval and commonly known as a Special Needs Trust. The second type is established for a person with a disability using funds of someone other than the person with a disability or their spouse, or someone legally obligated to pay any sum for damages or any other purpose to, or for the benefit of, the trust beneficiary. This type of trust is commonly known as a Supplemental Needs Trust.

Specials Needs Trust:

Using funds of the disabled person, these trusts are created by the person's parent, grandparent, guardian, or by the court. Minnesota and federal law allow for the establishment of these types of trusts based on Congress's enactment of the Omnibus Budget Reconciliation Act of 1993 (OBRA

93), prior to which there was uncertainty whether an inheritance, or a settlement or award from a negligence claim (such as personal injury or medical malpractice), affected the eligibility of the disabled person for government benefits. Through OBRA 93, Congress established exemptions for trusts for a person with a disability where the establishment of the trust meets the following conditions:

- (1) It is created while the individual with the disability is under the age of sixty-five (65);
- (2) It is created by a parent, grandparent, legal guardian, or court: and
- (3) Provides that upon the death of the disabled person the state will be reimbursed by the trust for the medical assistance it has provided, to the extent such amounts remain in the trust.

Special Needs Trusts are often referred to as "pay-back" trusts, because they are valid only if the state is reimbursed at the termination of the trust. If the disabled person has resided in more than one state, the trust must also provide that funds remaining in the trust be distributed proportionately to each state's reimbursable share. Special Needs Trusts can continue after the person becomes age 65. However, amounts funded to the trust after the person reaches age 65 will not be exempt. Therefore, careful consideration and care must be given to circumstances where funds from a structured settlement arrangement could potentially continue after age 65.

Supplemental Needs Trust:

This type of trust can be established for a beneficiary with a disability who is under the age of 64, to supplement government benefits and avoid ineligibility or reduction of such benefits. Medicaid and other such benefit programs account for the resources and income of a disabled person to determine eligibility for, and the amount of, assistance. Through a Supplemental Needs Trust, a family member or some other individual may establish a trust for an individual with a disability, without jeopardizing the beneficiary's eligibility for Medicaid, social security or other government benefits.

Minnesota law provides direct authority for Supplemental Needs Trusts. For purposes of such a trust, "a person with a disability" is defined as someone who has a physical or mental illness or condition which lasts for a continuous period of 12 months or more and would substantially impair the person's ability to provide for their own care or custody and is considered to be a person with a disability under the disability criteria specified in the Federal Social Security Act. The objectives of a Supplemental Needs Trust must be to provide for the reasonable living expenses and other basic needs of a person with a disability when benefits from publicly funded benefit programs are inadequate. The trust must, through its terms, meet certain conditions including that it may:

- (1) Authorize distribution to provide for all or any portion of the reasonable living expenses of the beneficiary;
 - (2) Allow or require distributions only in ways and for purposes that supplement or complement the benefits available under Medical Assistance, Minnesota Supplemental Aid, and other publicly funded benefit programs for disabled persons rather than to supplant those benefits;
 - (3) Contain provisions that prohibit disbursements that would have the effect of replacing, reducing, or substituting for publicly funded benefits otherwise available to the beneficiary or rendering the beneficiary ineligible for publicly funded benefits; and
 - (4) That although the trust does not necessarily need to terminate when the beneficiary attains age 65, no additions to the trust may be made after the event.
- Special Needs and Supplemental Trusts are an important topic of discussion for families of disabled persons, and can be a very effective tool to shelter and protect assets from consumption while maintaining eligibility for government assistance programs.



TO TRUST OR NOT TO TRUST?



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A revocable trust, also called a living trust, is a trust that may be altered or terminated during the grantor's lifetime.

There are three aspects to the creation of a trust: execution and creation of a trust agreement, funding of the trust, and management of the trust assets.

A revocable trust is established when the grantor prepares and executes a trust agreement which sets forth the terms and conditions of the revocable trust. The trust agreement will contain specific provisions allowing the grantor to manage, invest and spend the trust assets for his or her own benefit during the grantor's lifetime. The trust agreement will also allow for an initial trustee and a successor trustee who will take over management of the trust assets upon the mental incapacity or death of the grantor. The grantor appoints either one or more trustees to manage and control the trust assets. The grantor may be the sole trustee. Finally, the trust agreement will set forth what happens to the trust assets upon the death of the grantor. The trust assets will either be distributed to named beneficiaries upon the death of the grantor, or the trust will remain in existence for a certain period of time and for the benefit of named beneficiaries.

After creating the revocable trust, the grantor transfers personal assets into it, which is referred to as funding the trust. A trust is meaningless unless real or personal property is expressly transferred to the trustee on behalf of the trust. For example, to transfer real property into a revocable trust,

the grantor must execute and record a deed transferring the real property to the trustee of the trust. Common assets placed into a trust are real estate, business interests, money market accounts, stocks, bonds and mutual funds.

After funding the trust, the trustee of the trust manages the trust assets for the benefit of the named beneficiaries. The grantor is typically the beneficiary during the grantor's lifetime, and is entitled to receive income from the trust assets during his or her lifetime. Remainder trust beneficiaries typically receive nothing until after the grantor's death. Upon the grantor's death, the trust is either terminated with the trust assets distributed to the remainder beneficiaries or it is continued in existence for the benefit of named beneficiaries, such as a spouse or children.

There are many benefits to using a revocable trust. First, assets held in the name of a revocable trust will pass directly to the beneficiaries named in the trust agreement without the need for probate. Second, a revocable trust provides long-term property management by the grantor. A revocable trust allows the grantor to appoint himself or herself as trustee and exercise complete control over trust assets. Third, assets held in the name of a revocable trust at the time a person becomes mentally incapacitated will be managed by

a successor trustee named by the grantor in the trust instrument, instead of by a court-appointed guardian or conservator.

There are a few matters to be kept in mind when considering whether or not to use a revocable trust for estate planning purposes. First, a trustee must keep separate records for trust assets and will have to file separate income tax returns for the trust. Trust assets cannot be comingled with the grantor's assets held outside of the trust. For example, income received from trust assets and expenses paid for trust assets must pass through an account specifically held by the trust and not through a grantor's personal account. Second, assets funded into a revocable trust will still be considered personal assets for creditor and estate tax purposes. Trust property is considered personal property for estate tax purposes and will be subject to both state and federal estate taxes. Third, a revocable trust does not necessarily replace a last will and testament. Assets not formally transferred to the trustee will probably not be considered part of the trust and may still be subject to probate upon the grantor's death. Therefore, a Pour-Over Will is typically executed simultaneously with a revocable trust and used to transfer or "pour" all of the grantor's remaining property into the living trust upon his or her death.



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Often a family trust will provide that assets be held until children reach a mature age before they get full control of assets. Funds can be held in a trust for all children or a separate trust can be created for each child.

In sum, a trust can be set up in several ways to manage and distribute property to family members of your choosing. Common reasons for considering a trust include the reduction or elimination of estate taxes, avoidance of probate, and management and protection of assets for younger generations. If you are interested in learning more about whether a trust may be appropriate in your estate plan, we encourage you to contact your estate planning professional.



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- Administering wills, trusts, conservatorships, and guardianships

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