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Use of Inter Vivos Trusts in Agricultural Estate Planning

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USE OF INTER VIVOS TRUSTS IN AGRICULTURAL ESTATE PLANNING

I. INTRODUCTION

Agriculture has undergone tremendous changes since colonial times. It was during that period, when there was an abundance of unclaimed land and a scarcity of labor, that the ideal of the family farm developed.¹ Thomas Jefferson viewed this ideal, which he felt promoted self-reliance, as essential to self-government.² He felt that we could safely rely on government by the majority "as long as we remain virtuous."³ Virtue would last, "[a]s long as agriculture is our principal object. . . . When we get piled upon one another in large cities . . . we shall become corrupt as in Europe, and go to eating one another as they do there."⁴

The status of agriculture within our economy has changed a great deal since Jefferson's era. Approximately 90 percent of the work force was directly engaged in farming operations during the colonial period.⁵ Since that time, the percentage has decreased quite consistently, until in 1960 it was down to six percent.⁶ This contraction of the agricultural work force has been accompanied by an increase in size of the average farm.⁷ The combination of the increasing size of the average farm and rapidly rising prices in recent years for farm land and equipment⁸ have contributed to make the farm unit represent a large capital investment.⁹ It has been predicted that by the year 2000, a farm may represent an investment of millions of dollars.¹⁰

It appears that half of Iowa's present farm owners received some direct family assistance in acquiring farm ownership.¹¹ With the in-

¹ See Hill and Maier, *The Family Farm in Transition*, in *THE YEARBOOK OF AGRICULTURE* 1963, at 166 (U.S. Dep't of Agriculture, A. Stefferud ed.).

² *Id.*

³ C. BEARD, *JEFFERSON, CORPORATIONS AND THE CONSTITUTION* 563 (1936).

⁴ *Id.*

⁵ Freeman, *Agriculture in the Year 2000 A.D.*, 33 *VITAL SPEECHES OF THE DAY* 290, 292 (1967).

⁶ The percentage of the work force employed in agriculture declined to 72 percent in 1820, 59 in 1860, 38 in 1900, 27 in 1920, 12 in 1950, and 6 in 1960. Hill and Maier, *supra* note 1 at 167.

⁷ See Harl, *Estate and Business Planning for Farmers*, 19 *HASTINGS L.J.* 271, 272 nn.7 & 8 (1968).

⁸ Farm equipment costs are rising at a rate of approximately five percent a year. See Krumme, *How to Make a \$20,000 Machinery Decision*, *SUCCESSFUL FARMING* 32 (Machinery Management Issue 1970).

⁹ Between 1940 and 1966, per farm capital increased nationally at constant dollars from \$6,158 to \$65,960. See Harl, *supra* note 7, at 272 n. 8.

¹⁰ Freeman, *supra* note 5, at 291.

¹¹ See O'BYRNE, TIMMONS & HINES, *PLANNING FARM PROPERTY TRANSFERS WITHIN FAMILIES IN IOWA* 5 (Iowa State Univ. Bull. P-125, rev. ed. 1966) [hereinafter cited at O'BYRNE, TIMMONS & HINES].

creased costs involved in farm ownership, the need for direct family assistance to begin farming is likely to become greater. The fact that most farm owners have more than one child¹² may make it difficult to keep the farm within the family unit, if each child is to be treated fairly. This difficulty is compounded if the farmer and his wife must rely on income generated from the farm during their retirement. In addition, increasing estate settlement costs will place a greater financial burden on farmers' estates in the future.¹³ It has traditionally been the estate planner's role to cope with these types of problems. The farm estate planner is, in this respect, the same as other estate planners. However, agricultural real estate poses some unique psychological and legal problems in estate planning. It will be the scope of this Note to examine various farm situations and discuss how inter vivos¹⁴ revocable¹⁵ and irrevocable¹⁶ trusts may be employed to solve many of the difficulties associated with agricultural estate planning. Particular attention will be given to the problems of transferring farm property within the owner's immediate family and minimizing estate settlement costs and problems.¹⁷

II. FARM SITUATIONS AND PROBLEMS

Typical farm situations would appear to fall within three basic categories. In some instances the farm owner may have several farms, each of which is capable of being operated as a separate functioning unit. Such farmers' estate plans will probably concentrate on reducing death costs since they should be in a position to make permanent pre-death dispositions of some of the farm assets. Whether or not one of the farmer's heirs desires to continue the farming operation should pose few problems when formulating the estate plan.

Most farmers, however, are not so fortunate as to have extensive land ownership.¹⁸ The farm they are living on will represent, for many of these farmers, the bulk of their net worth. They are unable to make outright gifts of their property during their lifetime since they must

¹² *Id.* at 6.

¹³ *Id.* at 32-33.

¹⁴ An inter vivos trust is any trust created during the settlor's lifetime. Such trusts are often labeled "living trusts". See G. BOGERT, *TRUSTS & TRUSTEES* § 1, at 8 (2d ed. 1965) [hereinafter cited as BOGERT].

¹⁵ A revocable trust may be terminated by the settlor at any time with the property placed in the trust then returned to the settlor. See IV A. SCOTT, *THE LAW OF TRUSTS* § 330 (3d. ed. 1967) [hereinafter cited as SCOTT].

¹⁶ In an irrevocable trust the settlor reserves no right to terminate the trust arrangement. *Id.* § 331.

¹⁷ It is beyond the scope of this Note to discuss purposes other than immediate family farm transfers for which an inter vivos trust may be used. For example, the limitations on testamentary gifts to charity may be avoided by placing farm property in an inter vivos trust. See Hines, *Freedom of Testation and the Iowa Probate Code*, 49 IOWA L. REV. 724, 740 (1964). Also, this device can be employed to favor grandchildren, thereby avoiding a generation of estate settlement costs. See O'BYRNE, TIMMONS & HINES 4.

¹⁸ See O'BYRNE, TIMMONS & HINES 6.

rely on the income from this farm to live during retirement.¹⁹ If extraordinary expenses are incurred, a mortgage on the farm would probably be necessary to raise the required funds to pay for the emergency. Consequently, farmers owning a single farm unit would not appear to be in a position to make permanent inter vivos dispositions of the farm property in order to reduce death costs.

Among those farmers who own a single farm, some have no heirs who desire to continue the farming operation. A farmer in such a situation may wish to preserve the farm intact for income producing purposes. When the farm is ultimately sold, however, he may not be concerned whether the farm remains as a unit. Identity of the vendee or vendees would probably not be important. Thus, inter vivos arrangements within such an estate plan will probably concentrate on providing for the farmer and his spouse for the remainder of their lives.

The third basic farm situation which will be considered is that which is commonly called the family farm. In this situation the farmer will usually have several heirs, at least one of whom desires to continue the farming operation.²⁰ Preservation of the farm as a unit would appear to be one of the most important objectives within the farmer's estate plan. Therefore, the estate planner must attempt to find a way to accomplish this goal, while assuring that adequate provisions are made for the farmer's retirement years.

Some farmers and their estate planning objectives, of course, will not fit neatly into one of the above discussed factual situations. A farmer may own several farms, and desire to dispose of one to lower death costs, while retaining control over others for retirement income. The typical family farmer, owning a single farm unit, may have sufficient non-farm investments so that he need not rely on his farm for retirement income. In such a situation, the farmer may wish to effect a permanent pre-death disposition of his farm to minimize death costs and ensure that the farm stays within the family unit. Thus, the estate planner considering employment of an inter vivos farm trust to accomplish his client's objectives may have to modify the approach suggested by one of the three basic farm situations. The trust principles which will be examined in this note, however, can be applied to these variations in typical farm situations. When the farmer has determined his estate planning objectives, the type of trust which would be most advantageous for a particular client should become apparent.

III. OBJECTIVES COMMON TO ALL THREE BASIC FARM SITUATIONS

All farmers, no matter how extensive their land holdings or varied their family situations may be, would probably like to avoid problems and delays associated with probate administration. In addition, since farm owners generally die before their wives,²¹ a farmer's estate plan must adequately provide for a surviving spouse. Both of these objectives can be accomplished through the use of an inter vivos trust.

¹⁹ See *id.* at 21.

²⁰ *Id.* at 5-6.

²¹ See INSTITUTE OF LIFE INS., LIFE INS. FACT BOOK 93 (1969).

A. Avoidance of Probate Problems

Presently, it appears that joint tenancy is a form of land ownership which farm owners and their wives frequently employ to avoid probate.²² Most farmers, however, are probably not aware of the serious tax disadvantages created by placing too much farm property in joint tenancy.²³ An inter vivos trust can be employed to alleviate the tax disadvantages of joint tenancy²⁴ while avoiding the need for probate administration.

In order to successfully avoid probate, the terms of the trust instrument must transfer an interest in trust property to the beneficiaries during the farmer's lifetime.²⁵ Problems can arise in determining whether or not such an interest has in fact been created.²⁶ Generally, however, the transfer of a beneficial interest during the settlor-farmer's lifetime would be the essence of an inter vivos farm trust.

If a decedent's farm is part of his probate estate, the personal representative must obtain the necessary authorization to continue the farm business during probate. Absent such authorization within the decedent's will he would require a court order allowing the continuation.²⁷ A court order of this type would appear to be quite easy to obtain for continuation of a farming operation. There may be crops to be harvested, livestock to market, or any of numerous other jobs which require attention during probate.

There is always a chance, however, that some interested party may oppose the granting or retention of necessary authority by the personal representative.²⁸ He may feel that this person is not qualified to continue the farming operation, or he may have a more selfish reason for opposing the order. Whatever the motive, obtaining court authorization over the objection of an interested party will involve extra expense and additional delay in administration of the decedent's farm. No such problems can arise if the farm is placed in an inter vivos trust, since legal title to the farm is transferred to the trustee

²² See Hines, *Real Property Joint Tenancies: Law, Fact, and Fancy*, 51 IOWA L. REV. 582, 587, 596-97 (1966).

²³ *Id.* at 599-601; Riecker, *Joint Tenancy: The Estate Lawyer's Continuing Burden*, 64 MICH. L. REV. 801, 810-16 (1966).

²⁴ See notes 99-105 *infra*, and accompanying text.

²⁵ See T. ATKINSON, *ATKINSON ON WILLS* § 42, at 177-78 (1953).

²⁶ See notes 76-80 *infra* and accompanying text.

²⁷ Several states have statutes which provide for a court order allowing continuation of a decedent's business without consent of interested parties. In jurisdictions where consent is required the rights of minors and creditors cannot be impaired by continuation of the business. Their consents may be difficult to obtain. See T. ATKINSON, *supra* note 25, § 121, at 661-62.

In Iowa, a personal representative may obtain an order to continue the business without consent, "Upon a showing of advantage to the estate. . . ." IOWA CODE § 633.83 (1966).

²⁸ In Iowa, "The court may on its own motion, and upon the application of any interested party *shall*, review such [business continuation] authorization, and upon such review, may revoke or modify the same." IOWA CODE § 633.83 (1966). (emphasis added).

upon creation of the trust, and is not affected by the settlor-farmer's death and subsequent probate proceedings.²⁹ Thus, managerial arrangements established within the trust instrument creating the inter vivos trust continue without regard to the settlor's demise.³⁰ Competent management of the farming operation is not in danger of being suspended for a time following the settlor's death.

In most states, allowable executor and attorney fees will vary with the value of the probate estate.³¹ In such states there may be a considerable savings provided through employment of an inter vivos farm trust, since such a trust would probably contain the bulk of most farmers' assets. Some jurisdictions, however, base the maximum allowable executor and attorney fees on the value of the gross estate included for state death tax purposes.³² In such states, the form of trust employed by the settlor may determine whether or not any savings in ordinary probate expenses will be obtained, since a farm placed in an irrevocable trust beyond the farmer's control will generally not be part of his taxable estate, but a farm trust in which the farmer retains an interest for himself will be included.³³

A farm owner, after retiring, may move to another jurisdiction taking certain personal assets with him. If his entire estate passes through probate, probate proceedings will probably be required in both of these states.³⁴ This requirement appears to stem from the notion that a personal representative's authority to deal with assets of the decedent does not extend beyond the jurisdiction in which he is appointed. As a rule, he cannot sue or be sued in another state.³⁵ Also, in some states the personal representative of a decedent must be a resident of that jurisdiction.³⁶ The domiciliary appointee, therefore, may not qualify for appointment where the farm is located. Such ancillary proceedings create unnecessary expenses and delays during administration of the estate and can be avoided through employment of an inter vivos trust.

²⁹ See R. HENDRICKSON, *INTERSTATE AND INTERNATIONAL ESTATE PLANNING* § 4.78, at 223 (1968).

³⁰ *Id.* at 223.

³¹ See Bauer, *Watch Those Fees!*, 104 *TRUSTS AND ESTATE* 1117 (1965).

³² In Iowa, the probate code authorizes attorneys and personal representatives each to charge a reasonable fee not in excess of a percentage of the gross value of the estate included for Iowa inheritance tax purposes. This fee varies from six percent on the first \$1,000 to two percent on all amounts over \$5,000. IOWA CODE ANN. §§ 633.197-198 (1966). Iowa's rates appear to be the fifth lowest in the nation. Bauer, *Legal Fees in Probate*, 105 *TRUSTS AND ESTATES* 850, 851-53 (1966).

³³ If the settlor reserves income from an inter vivos trust for himself, or reserves power to revoke, alter or amend the trust, it may be pulled back into his estate for estate and inheritance tax purposes, even though it is not part of the probate estate. INT. REV. CODE OF 1954, §§ 2036-38.

³⁴ See Currie, *The Multiple Personality of the Dead: Executors, Administrators, and the Conflicts of Laws*, 33 U. CHI. L. REV. 429-30 (1966); Note, *Full Faith and Credit to Judgments Against Estate Representatives*, 48 IOWA L. REV. 93-94 (1962).

³⁵ See Note, *supra* note 34, at 94-95.

³⁶ See, e.g., KY. REV. STAT. ANN. § 395.005 (1969); MICH. COMP. LAWS ANN. § 704.27 (1968); NEB. REV. STAT. § 30-315 (1964).

Ancillary administration can be avoided by using an inter vivos trust since legal title to the farm located in a jurisdiction other than the owner's present domicile is placed in the hands of the trustee.³⁷ The disposition which will be made of the property is set by the terms of the trust.³⁸ The property is, consequently, not part of the probate estate within the settlor's domicile or any other jurisdiction. Thus, the conflicts of laws questions, added expenses, and delays which may arise during ancillary administration are avoided.

By placing his farm in an inter vivos trust, the farm owner can effect a firm and apparent settlement of his intent concerning ultimate disposition of the farm property. He has had a chance to implement the trust and observe its operation. Thus, although the grounds for challenging an inter vivos trust are the same as for a will,³⁹ it appears to be much more difficult to successfully challenge the validity of an inter vivos trust after the settlor's demise than to challenge a will during probate.⁴⁰ This should help discourage potential litigants who may otherwise attempt to contest a testamentary disposition.⁴¹

Avoidance of probate problems through placing farm property in an inter vivos trust, therefore, will afford several advantages to the farm owner. Competent managerial arrangements are established before death and continue without interruption. Expenses and delays involved in ordinary and ancillary probate proceedings are minimized. The probability of having dispositions challenged by a disgruntled heir is reduced. Thus, avoidance of probate may be a sufficient reason by itself for employing an inter vivos trust in a farmer's estate plan.

B. Providing For a Surviving Spouse

Recent technological innovations in the agricultural field have made farming a highly complex business. During the course of a normal year's farming operation many decisions must be made which require the ability to critically analyze alternative courses of action available to the farmer. He must decide whether or not fertilizer and herbicides should be used on his farm, and which type is best suited to his operation. New, more modern machinery is available to the farmer every year. The cost of acquiring new equipment must be balanced against

³⁷ See R. HENDRICKSON, *supra* note 29, § 4.78, at 222-23.

³⁸ See Heffernan & Williams, *Revocable Trusts in Estate Planning*, 44 CORNELL L.Q. 524, 539 (1959).

³⁹ See *Harrison v. City National Bank*, 210 F. Supp. 362, 370-71 (S.D. Iowa 1962) (lack of competency); *Reiss v. Reiss*, 45 Cal. App. 2d 740, 745, 114 P.2d 718, 721 (1941) (undue influence).

⁴⁰ See Hendrickson, *Who Needs a Revocable Trust—and Why?*, 104 TRUSTS AND ESTATES 842 (1965). A will must be subjected to judicial scrutiny prior to becoming effective. Notice is served on interested parties, and witnesses must be produced by the personal representative. An inter vivos trust, on the other hand, is effective from the time of creation. This difference in procedure appears to be the reason why an inter vivos trust is more difficult to challenge than a will during probate. *Id.* at 842-43.

⁴¹ See Bostick, *The Revocable Trust: A Means of Avoiding Probate in the Small Estate?*, 21 U. FLA. L. REV. 44, 51 (1968).

added efficiency of production which such machinery can provide.⁴² An improper decision in these and many other areas of farm management may be disastrous to the farming operation. The ability to make this type of decision is not easily acquired. Even after a lifetime of farming it is doubtful that any farmer can be sure his judgment is always correct.

The average farm wife is undoubtedly familiar with her husband's farming operation. In the majority of cases her ability to replace her husband as farm manager, however, is questionable. Most farm wives probably lack the technical competence required to successfully continue the farm business without the assistance of a third party. She will usually be at an age when learning new, highly technical skills is difficult. In addition, this may be a time when even the very capable surviving spouse has no interest in assuming the burden of farm management. If the farm is placed in an inter vivos trust, the managerial skills which are required will be provided, and the surviving spouse can be assured she will receive the income from the farm for the remainder of her lifetime.

The terms of the instrument creating the farm trust can provide for the managerial arrangements which the farm operator feels will be best for his farm.⁴³ These arrangements can continue for the duration of the inter vivos farm trust.⁴⁴ If a provision is placed in the trust instrument granting the income produced by the farm to the operator's surviving spouse for the rest of her life,⁴⁵ the farmer can be reasonably assured that his widow will receive adequate support from the farm following his death.

IV. THE OBJECTIVE OF MINIMIZING DEATH TAXES

A farmer who owns several farms is probably concerned over the substantial estate and inheritance tax liability which will accrue if he dies owning these farms. In order to reduce this potential tax liability, a farmer with extensive land ownership should consider making permanent inter vivos dispositions of some of his farm property. Generally, such a disposition should take the form of an outright gift.

So long as the donee of farm property is willing and capable of properly managing the gift, placing it in trust is probably unwise. The expenses of creating the trust and paying the trustee his fees would

⁴² Average prices paid by farmers for equipment have increased steadily. For example, the average cost of comparable four-row corn planters increased from \$549 in 1957-59 to \$919 in 1968. See U.S. DEP'T OF AGRICULTURAL STATISTICS 472 (1969).

⁴³ The trust instrument must be carefully drafted in order to authorize the flexibility of management necessary for a successful farm-trust arrangement. If the terms of the trust are not explicit, the trustee may fear exceeding his management authority. See O'Byrne, *Devises of Farm Land*, 49 ILL. B.J. 122, 127-28 (1960). A form has been suggested which will assure the trustee necessary management authority. See Logan, *Estate Planning: The Special Problems of the Farmer in Disposition by Will*, 32 ROCKY MT. L. REV. 329, 353-56 (1960).

⁴⁴ Cf. II SCOTT § 107, at 840-41; IV SCOTT § 331, at 2618.

⁴⁵ The estate tax implications of gifts of trust life estates to widows will be discussed in notes 106-12 *infra*, and accompanying text.

be unnecessarily incurred.⁴⁶ The presence of a third party trustee would also create an undesirable obstacle between the donee and the farm property. However, there are certain situations in which a trust rather than an outright gift should be used to reduce death taxes.

If a potential donee of a portion of the farmer's assets is incapacitated, or for some reason the farmer believes he may squander the gift, a trust may be employed to preserve the gift. Such a trust could take the form of either a discretionary⁴⁷ or spendthrift⁴⁸ trust. In either case a donee's access to farm property placed in trust would be greatly restricted.⁴⁹ If a valid spendthrift trust is created, the farm owner-settlor can determine how much income the beneficiary should receive each year, and payments will be limited to this amount.⁵⁰ The trustee of a discretionary trust, on the other hand, determines how much of the total income generated by the farm property shall be granted to the trust beneficiary.⁵¹ Creditors and assignees of the beneficiary cannot generally levy against farm property placed in either of these trust forms.⁵² Thus, by permanently placing farm property in a discretionary or spendthrift trust a farmer with extensive land ownership can reduce death taxes and provide a steady source of income for a donee who may not be capable of managing the gift himself.

Employment of a discretionary or spendthrift inter vivos trust to minimize death taxes requires that the farm owner sever all his interest in the trust property. Retention by the settlor of an income interest,⁵³ reversionary interest,⁵⁴ or the power to alter, amend, or revoke the trust,⁵⁵ is sufficient to cause inclusion of the trust property in the farmer's gross estate for federal estate tax purposes. In addition, state inheritance taxes are generally levied upon such property.⁵⁶

⁴⁶ There seems to be a fair degree of uniformity of trustee's fees charged by Iowa banks for the management of farm property. Fees are generally 10 percent of the farm owner's gross receipts with a minimum charge of \$50 annually. O'BYRNE, PHELAN & WULF, *WORKBOOK FOR IOWA ESTATE PLANNERS* §§ 2A7.21-22 (1966).

⁴⁷ See *Kiffner v. Kiffner*, 185 Iowa 1064, 1066, 171 N.W. 590, 591 (1919) (valid in Iowa against creditors); *RESTATEMENT (SECOND) OF TRUSTS* § 155 (1959).

⁴⁸ See *In re Estate of Bucklin*, 243 Iowa 312, 320-21, 51 N.W.2d 412, 416-17 (1952) (valid in Iowa against claims of the beneficiary's wife); *BOGERT* § 222.

⁴⁹ See authorities cited notes 47-48 *supra*.

⁵⁰ See II *SCOTT* § 152.1.

⁵¹ *Id.* § 155.

⁵² See, e.g., *Nichols v. Eaton*, 91 U.S. 716, 726, 730 (1875) (discretionary trust); *In re Estate of Bucklin*, 243 Iowa 312, 320-21, 51 N.W.2d 412, 416-17 (1952) (spendthrift trust); *Town of Randolph v. Roberts*, 346 Mass. 578, 579-80, 195 N.E.2d 72, 73-74 (1964) (discretionary trust); *Citizens Bank v. Buford*, 232 Mo. App. 676, 681, 108 S.W.2d 1062, 1065-66 (1937) (spendthrift trust).

⁵³ *INT. REV. CODE OF 1954*, § 2036. For an explanation of this Code section, see C. LOWNDES & R. KRAMER, *FEDERAL ESTATE AND GIFT TAXES* §§ 8.1-8.20 (1962) [hereinafter cited as *LOWNDES & KRAMER*].

⁵⁴ *INT. REV. CODE OF 1954*, § 2037, discussed in, *LOWNDES & KRAMER* §§ 7.1-7.10.

⁵⁵ *INT. REV. CODE OF 1959*, § 2038, discussed in, *LOWNDES & KRAMER* §§ 9.1-9.15.

⁵⁶ See, e.g., *IOWA CODE ANN.* § 450.3 (Supp. 1970); *NEB. REV. STAT.* §§ 77-2002(b), (c) (1958); *WIS. STAT. ANN.* § 72.01(3)(b) (1969).

Therefore, to be successfully used as a vehicle for reducing death taxes, the terms of an inter vivos trust must irrevocably transfer trust property beyond the farmer's control.

Creation of a trust which would otherwise place farm property outside the farmer's gross estate for tax purposes may fail as a tax savings device, however, if the farmer dies within three years following its creation. Such an event creates a presumption that the trust was established in contemplation of death, and is, therefore, to be included in the farmer's gross estate.⁵⁷ This presumption is rebuttable upon proof that the primary purpose for placing the farm property in trust was not to reduce death taxes.⁵⁸ Effectively removing farm property from the owner's gross estate by placing it in an irrevocable trust, however, will not avoid all tax liability arising from the transfer.

If the farm owner does sever all ties to inter vivos farm trust property, he will incur a potential tax liability at that time. Establishment of an irrevocable trust creates a complete gift for gift tax purposes.⁵⁹ Gift tax rates, however, are considerably lower than the estate tax rates.⁶⁰ If a farmer makes maximum use of the split gift provision,⁶¹ the lifetime exemption allowed to the settlor and his spouse,⁶² and if the annual exclusion is available,⁶³ total tax liability on the transfer will be a good deal less than if the farm is included in his taxable estate. Placing a large amount of farm property in an irrevocable trust in the same year, however, may cause accrual of a substantial tax liability.⁶⁴

To minimize the impact of the gift tax, the settlor may wish to schedule his donations to the trust over several years, and take advantage of the annual exclusion from gift tax liability. This annual exclusion, however, is not allowed for gifts of future interests.⁶⁵ The regulations define future interests to include any gift under which a

⁵⁷ INT. REV. CODE OF 1954, § 2035, discussed in LOWNDES & KRAMER §§ 5.1-5.14.

⁵⁸ See authorities cited note 88 *supra*. In one exceptional case it was held that gifts made by a 99 year old man to his grandchildren "were made for motives associated with life and were not in contemplation of death". *Kniskern v. United States*, 232 F. Supp. 7, 12 (S.D. Fla. 1964).

⁵⁹ INT. REV. CODE OF 1954, § 2511; TREAS. REG. § 25.2511-1(h) (7) (1961); LOWNDES & KRAMER §§ 27.1-27.10.

⁶⁰ Compare INT. REV. CODE OF 1954, § 2001 (estate tax rates) with § 2502 (gift tax rates). Gift tax rates are 75 percent of the estate tax rates.

⁶¹ *Id.* § 2513(a).

⁶² *Id.* § 2521.

⁶³ The donor of a gift may be able to exclude from gift tax liability the first \$3,000 in value given to each donee per year. *Id.* § 2503(b).

⁶⁴ Assume a farm owner irrevocably transfers property with a fair market value of \$150,000 into a non-discretionary irrevocable trust, all in the same year, naming his three children as beneficiaries. Further assume neither he nor his wife have used any of their \$30,000 lifetime exemptions to which each is entitled. Applying the split gift provision which exempts a total of \$60,000 and excludes \$6,000 per donee, there remains a taxable gift of \$72,000. The tax liability on this gift will be \$9,645. INT. REV. CODE OF 1954, §§ 2521, 2513(a), 2503(b), 2502.

⁶⁵ INT. REV. CODE OF 1954, § 2503(b), discussed in, LOWNDES & KRAMER §§ 33.1-33.12.

donee's interest is "limited to commence in use, possession or enjoyment at some future date or time."⁶⁶ This definition has been held to include gifts placed in a discretionary trust, since the donee's possession and enjoyment of that gift is subject to the trustee's will.⁶⁷ The present value of the income interest of farm property transferred to a spendthrift or other mandatory trust will qualify for the annual exclusion to the extent the beneficiaries have an enforceable right to the trust income.⁶⁸ The objective, therefore, of reducing gift tax liability by spreading the gifts to the trust over a period of years is not achievable so long as a discretionary trust is utilized. Donations to an irrevocable mandatory trust, however, will qualify for the annual exclusion to the extent of the present value of the donee's right to income generated by the trust property.

V. THE OBJECTIVE OF PRESERVING OWNERSHIP AND CONTROL

Some farmers, who have several farms and are in a position to lower death taxes by making permanent inter vivos dispositions of some of their farm property, may wish to retain an income interest over part of the property for support during retirement. They may also need some farm property for a source of emergency funds to pay for retirement expenses. Farmers with a single farming unit will probably have to rely on this farm for these same purposes. Thus, no matter how extensive a farmer's land ownership may be, the portion of his estate plan which is designed to protect the farmer and his wife during retirement may be quite similar.

This farm property can be placed in an irrevocable trust with income from the farm reserved for the joint lives of the farmer and his wife.⁶⁹ Having placed the farm in an irrevocable trust, however, the settlor-farmer has lost the power to mortgage or sell the property to raise funds for an emergency.⁷⁰ Since an income interest has been reserved in favor of the farm operator, death taxes will be levied on the full value of the farm.⁷¹ In addition, a gift tax liability is incurred on the irrevocable remainder interest when the trust is established.⁷² For these reasons, a more flexible estate planning tool should be employed

⁶⁶ TREAS. REG. § 25.2503-3(a) (1954), *upheld in*, United States v. Pelzer, 312 U.S. 399, 402-03 (1941) (local law not applicable in determining what qualifies as a future interest).

⁶⁷ See, e.g., Hutchings v. Commissioner 141 F.2d 422, 424 (5th Cir. 1944); Welch v. Paine, 130 F.2d 990, 992 (1st Cir. 1942); Burton v. United States, 60 F. Supp. 212, 218 (Ct. Cl. 1945); TREAS. REG. § 25.2503-3(c)(3) (1958).

⁶⁸ TREAS. REG. § 25.2503-3(b) (1958). In a spendthrift trust, the settlor determines how much of the trust income a beneficiary will receive, and he has an unqualified right to this amount. See note 50, *supra*.

⁶⁹ See I SCOTT § 57.1, at 475.

⁷⁰ Cf. BOGERT § 998, at 455. The settlor, absent consent of all the beneficiaries under the trust, cannot generally terminate an irrevocable trust unless he shows a mistake occurred in drafting the trust instrument or he is allowed by statute to revoke for a particular reason. See *id.* §§ 998-99.

⁷¹ INT. REV. CODE OF 1954, § 2036; IOWA CODE ANN. § 450.3 (Supp. 1970); NEB. REV. STAT. § 77-2002(b) (1958); WIS. STAT. ANN. § 72.01(3)(b) (1969).

⁷² INT. REV. CODE OF 1954 § 2511(a); TREAS. REG. § 25.2511-1(e) (1961).

to provide for the farmer's retirement. Such a device is available in the form of a revocable inter vivos trust.

A. A Revocable Trust Within the Estate Plan

Some of the primary purposes for employing a revocable trust are those previously discussed. They include avoidance of probate, providing for a surviving spouse, and reservation of an income interest over the farm trust. An irrevocable trust can be used to accomplish these objectives also. However, the settlor of a revocable trust may reserve a sufficient element of control over farm property placed in trust to make this device ideal for the farm which must protect a farmer and his wife during retirement.

By the terms of the revocable trust instrument the settlor-farmer can reserve the right to alter, amend or revoke the trust in any manner and at any time he desires.⁷³ There are many reasons why a farmer may not want to surrender control over the farm trust property. If an emergency arises, the trust can be partially revoked and property mortgaged to provide funds for the emergency. The farm owner may wish to be consulted when important management decisions concerning the farm are made. He can, probably, make his concurrence a prerequisite to such decisions.⁷⁴ These are only two of many possible reasons why a farm owner may desire to retain some control over farm property placed in trust. Regardless of the owner's motives, however, a revocable inter vivos trust appears to be able to come as close to leaving the settlor with complete ownership, while effecting a non-testamentary disposition of his farm property as any estate planning tool available.⁷⁵

1. Validity of the Revocable Trust

The degree of control which a farmer may retain over a revocable farm trust makes the trust appear quite testamentary in nature.⁷⁶ Any interest which the beneficiaries have in the trust property prior to the settlor's death can be easily destroyed by the settlor.⁷⁷ For all practical purposes, the farm owner's position in respect to property placed in a revocable trust is the same following creation of the trust as it was prior to that time.⁷⁸ Thus, the question arises whether or not a revocable trust might be invalid as an attempted testamentary disposition in violation of the Statute of Wills.

⁷³ See I SCOTT § 57.1.

⁷⁴ Retaining this degree of control over administration of the trust may cause the trust to be declared an invalid testamentary disposition of property. *Id.* § 57.2. In Iowa, however, it would appear that the settlor can reserve management power over a revocable real estate trust. See *Keck v. McKinstry*, 206 IOWA 1121, 1128, 221 N.W. 851, 855 (1928).

⁷⁵ See Casner, *Estate Planning—Avoidance of Probate*, 60 COLUM. L. REV. 108, 110 (1960).

⁷⁶ See Stevenson, *The Amazing Revocable Trust: A Study in Contradictions*, 32 U. CIN. L. REV. 1, 2 (1962).

⁷⁷ See Heffernan & Williams, *Revocable Trusts in Estate Planning*, 44 CORNELL L.Q. 524, 537-38 (1959).

⁷⁸ See *id.*; Casner, *supra* note 75, at 110.

The basic policy behind the requirements of the Statute of Wills appears to be that of safeguarding the decedent's intent.⁷⁹ This policy would not seem to be frustrated by upholding an arrangement which the deceased could have terminated at any time, but did not choose to terminate. Invalidation of the revocable trust form, therefore, would appear to be an unnecessary restraint on a farm owner's freedom of disposition over his property. Fortunately for settlors, most courts today hold that beneficiaries of a revocable trust have a sufficient interest in the trust property prior to the settlor's death to uphold this form of trust as an inter vivos disposition.⁸⁰

While it is appropriate for courts to uphold the validity of the revocable trust form, situations may arise in which non-recognition of the form is desirable. This is particularly true since the farmer is still enjoying what are generally considered to be incidents associated with complete ownership of his farm. Thus, if a farmer transfers legal title to a trustee for the purpose of cutting a spouse out of his estate,⁸¹ or for placing his farm property beyond reach of his creditors,⁸² the trust may, with justification, be declared invalid for this purpose. Once the spouse or creditor has received satisfaction, however, the remainder of the trust should stand.⁸³ Public policy is a sufficient reason for penetrating the trust in favor of a spouse or creditor, but it should not be used to frustrate the legitimate purposes for which a revocable farm trust may be created.

2. Tax Implications of a Revocable Trust

a. Stepped Up Basis

Under present law, if a farm owner makes a completed gift of appreciated farm property the donee assumes the donor's basis in that property,⁸⁴ increased only by the amount of gift tax levied on the gift.⁸⁵ The donor's death does not affect the basis of the donated property, because it is not included in the donor's taxable estate. The gift tax liability is measured by the fair market value of the gift.⁸⁶

Farm property which is included in the owner's gross estate for federal estate tax purposes gets a "stepped up" basis at the owner's

⁷⁹ See T. ATKINSON, *supra* note 25, at 292-93.

⁸⁰ See, e.g., Kelly v. Parker, 181 Ill. 49, 61, 54 N.E. 615, 618 (1899); Keck v. McKinstry, 206 Iowa 1121, 1128-29, 221 N.W. 851, 855 (1928); National Shawmut Bank v. Joy, 315 Mass. 457, 470-71, 53 N.E.2d 113, 122 (1944). *But see* Casner, *supra* note 75, at 109 n.7 and cases cited therein.

⁸¹ See, e.g., Smith v. Northern Trust Co., 322 Ill. App. 168, 176, 54 N.E.2d 75, 78 (1944); Ackers v. First Nat'l Bank, 192 Kan. 319, 333, 387 P.2d 840, 851 (1963); Newman v. Dore, 275 N.Y. 371, 381, 9 N.E.2d 966, 969 (1937).

⁸² See, e.g., Barth v. Severson, 191 Iowa 770, 780, 183 N.W. 617, 621 (1921); Keener v. Williams, 307 Mo. 682, 707-08, 271 S.W. 489, 497 (1925); Tichonchuk v. Orloff, 36 Misc. 2d 623, 626, 233 N.Y.S.2d 321, 325 (1962) (constructive trust).

⁸³ See Wanstrath v. Kappel, 358 Mo. 1077, 1084, 218 S.W.2d 618, 621 (1949); Tichonchuk v. Orloff, 36 Misc. 2d 623, 626, 233 N.Y.S.2d 321, 325 (1962).

⁸⁴ INT. REV. CODE OF 1954, § 1015(a).

⁸⁵ *Id.* § 1015(d).

⁸⁶ *Id.* § 2512(a).

death.⁸⁷ Since revocable trust property is included in the settlor's gross estate,⁸⁸ it will receive this step up. No gift tax liability accrues when a revocable trust is created, because such a gift is incomplete for gift tax purposes.⁸⁹

If the settlor-farmer establishes a long term post-death purchase arrangement in favor of an heir who is to continue farming, or if the farm is sold to an outsider after the farmer's death, a step up in basis may bring considerable tax savings. When the trust property is sold, taxable gain will be the difference between sales price and the stepped up basis of the farm trust property.⁹⁰ Thus, unless the farm property has appreciated only slightly during the decedent's ownership,⁹¹ the smaller gain realized upon a sale of the farm assets after the decedent's death, plus the absence of gift taxes incurred upon creation of a revocable farm trust, may obviate the concern that death taxes will not be decreased through the use of this trust form.⁹²

b. Mortgage Rather Than Sell

One purpose for retaining control over trust property may be to provide a source of funds to cover extraordinary expenses incurred during the farmer's retirement. In order to pay for such expenses, the settlor-farmer may find it necessary to revoke the trust and recover the trust property. Selling highly appreciated farm property, however, will incur a substantial income tax liability.⁹³ By mortgaging, rather

⁸⁷ *Id.* § 1014.

⁸⁸ *Id.* §§ 2036, 2038.

⁸⁹ *Burnet v. Guggenheim*, 288 U.S. 280, 288-89 (1933); *REV. RUL.* 395, 1958-2 *CUM. BULL.* 398, 399.

⁹⁰ *INT. REV. CODE OF 1954*, § 1001(a).

⁹¹ If a farmer purchased his farm for \$100,000, this ordinarily would be his basis in the farm property. *INT. REV. CODE OF 1954*, § 1012. If the farm's fair market value remains constant or decreases, the step up in basis will not occur, therefore, creating no tax savings. In such a situation, making a completed gift which will not be included in the donor's gross estate, in order to reduce death taxes, may become a more important objective. See notes 59-64 *supra*, and accompanying text.

⁹² In the hypothetical situation discussed in note 64 *supra*, assume the farm owner's basis in the property is \$30,000. If the owner creates an irrevocable trust, the three beneficiaries will assume this basis. Therefore, if fair market value and sales price of the property remain constant after the settlor's death, and the entire interest is sold to a third party, the potential taxable gain will be \$120,000. *INT. REV. CODE OF 1954*, § 1001(a). If the beneficiaries who sell their interests are in a tax bracket greater than 50 percent, they will each incur a tax liability of \$10,000 (25%) on the transfer. *Id.* § 1201(b).

If the assets are placed in a revocable trust, however, the potential gift tax of \$9,645, see note 64 *supra*, and the capital gain tax of \$30,000, *supra*, can be avoided. There will, of course, be an estate and inheritance tax levied on the property. The amount of these taxes will depend upon the total value of the gross estate, but with proper planning it should not exceed that which can be saved by obtaining a stepped up basis and avoiding a gift tax liability.

⁹³ The principles discussed in note 92 *supra* apply to a sale by the settlor also.

than selling the former trust property, this potential income tax liability can be avoided.

In order for tax liability to accrue on appreciated farm property, tax law requires subjecting it to a gain-realizing event.⁹⁴ Mortgaging farm property, even for an amount equal to the fair market value of the property, is not a gain-realizing event.⁹⁵ Income generated by the farm could be used to pay interest, which is deductible,⁹⁶ on the mortgage. When the farmer dies, his estate will receive a step up in the basis of the farm property. In addition, the unpaid portion of the mortgage would be deductible from the farmer's gross estate.⁹⁷ Thus, if revocation of the farm trust is necessary, mortgaging rather than selling the former trust property may bring considerable income and estate tax savings.⁹⁸

c. Maximum Use of the Marital Deduction

In 1964, approximately 50 percent of Iowa farms were being held in joint tenancy.⁹⁹ This form of property ownership, used so extensively by farm owners and their wives, creates severe problems for farm estate planners. The survivorship feature of joint tenancy affords immediate transfer of a decedent's interest to the surviving tenant.¹⁰⁰ His will is inoperative to devise an interest in the farm to anyone except the surviving tenant.¹⁰¹ The entire value of the farm will probably be included in the deceased tenant's gross estate,¹⁰² but this fact is mitigated because maximum use can be made of the marital deduction.¹⁰³ For this reason, no excess estate tax liability will accrue upon the husband's death.¹⁰⁴ If the surviving spouse continues to own the farm until she dies, the entire value of the property will also be included in her estate, since she is now sole owner of the farm. There will, however, be no marital deduction available to reduce the size of the surviving spouse's gross estate.¹⁰⁵ Thus, the survivorship feature of

⁹⁴ INT. REV. CODE OF 1954, § 1001(a).

⁹⁵ See *Woodsam Associates Inc. v. Commissioner*, 198 F.2d. 357, 359 (2d Cir. 1952).

⁹⁶ INT. REV. CODE OF 1954, § 163(a).

⁹⁷ *Id.* § 2053(a) (4).

⁹⁸ The income and estate tax savings generated by mortgaging rather than selling the farm property assumes that the mortgage proceeds will be used to pay for retirement expenses. If a portion of the mortgage proceeds is invested by the farmer, and remains under the farmer's control until his death, it will be included in his estate. INT. REV. CODE OF 1954, § 2033. This inclusion will cancel out any potential estate tax savings generated by deduction of the mortgage from the decedent's gross estate.

⁹⁹ See Hines, *supra* note 22, at 607.

¹⁰⁰ *Id.* at 596-97.

¹⁰¹ *Id.*

¹⁰² INT. REV. CODE OF 1954, § 2040.

¹⁰³ *Id.* § 2056(a), discussed in, LOWNDES & KRAMER §§ 17.1-17.23.

¹⁰⁴ See Hines, *supra* note 22, at 599-600.

¹⁰⁵ If the surviving spouse remarries and dies before her second husband, a marital deduction would be available for property devised to him. Unless she remarries, however, there is no possibility of a marital deduction from her gross estate. INT. REV. CODE OF 1954, § 2056(a).

joint tenancy may cause a substantial amount of excess estate tax to accrue on joint tenancy property. This excess can be avoided through proper employment of a revocable inter vivos trust.

If the joint tenancy is severed, and the farm transferred to a revocable trust, with the husband alone as grantor,¹⁰⁶ its terms may provide that a percentage, or all, of the income generated by the trust will be paid to the surviving spouse for the remainder of her lifetime. Standing alone, this type of life estate creates a "terminable interest" which does not qualify for a marital deduction in the husband's estate.¹⁰⁷ Coupling this life estate with a general power of appointment¹⁰⁸ over part of the trust property, however, creates an exception to the terminable interest rule.

A marital deduction is allowed for the value of property over which the power of appointment may be exercised.¹⁰⁹ That portion of the trust property will be included in the surviving spouse's gross estate upon her death.¹¹⁰ The remaining property, not subject to the power of appointment, will not be included in the gross estate of the surviving spouse.¹¹¹ Thus, by limiting the power of appointment to not exceed the amount necessary for a maximum marital deduction in the husband's estate, and providing for an income interest alone over the remainder of the trust property, excess estate tax potential of farms now held in joint tenancy can be avoided.¹¹²

3. *Advantages Particularly Applicable to the Family Farm*

A farmer who owns several farms is probably not very concerned about preserving all his farms as one unit following his death. If an heir desires to continue farming he can be granted sufficient land, perhaps during the farmer's lifetime, to ensure that he will have a good

¹⁰⁶ If the farm is presently being held in joint tenancy, it must be severed and transferred to a revocable trust in the husband's name, in order for a life estate-power of appointment in favor of the wife to act as an estate tax saving device. See Hines, *supra* note 22, at 600; Riecker, *supra* note 23, at 822-23. Assuming the husband furnished initial consideration for purchase of the farm, and when the joint tenancy was created he did not elect to treat it as a completed gift to his wife, no gift tax liability will accrue when the joint tenancy is so severed. See LOWNDES & KRAMER § 30.7, at 663; cf. TREAS. REG. § 25.2515-1(d) (1958).

¹⁰⁷ INT. REV. CODE OF 1954, § 2056(b) (1), discussed in, LOWNDES & KRAMER §§ 17.9-17.23.

¹⁰⁸ For purposes of obtaining a marital deduction, the power of appointment granted a surviving spouse must be "exercisable in favor of such surviving spouse, or the estate of such surviving spouse, or in favor of either. . ." INT. REV. CODE OF 1954, § 2056(b) (5).

¹⁰⁹ INT. REV. CODE OF 1954, § 2056 (b) (5), discussed in, LOWNDES & KRAMER §§ 17.17-17.21. See Allen, *Use of Trusts and Powers of Appointment in Estate Planning*, 21 ARK. L. REV. 15, 17-21 (1967); Holdsworth, *How to Obtain Maximum Utility From Trusts in Estate and Tax Planning*, 21 JOURNAL OF TAXATION 94-96 (1964).

¹¹⁰ INT. REV. CODE OF 1954, § 2041(a) (2).

¹¹¹ See LOWNDES & KRAMER § 4.6.

¹¹² If an Iowa farm, with a fair market value of \$120,000, is placed in trust employing a life estate-power of appointment remainder to the surviving spouse,

opportunity for a successful farming career. In addition, for a farmer who has only one farm and no heirs who want to continue farming, preservation of the farm unit after he and his wife are gone would probably not be important. However, in the family farm situation in which there is a single farm plus an heir who wants to continue farming, preservation of as much of the total farm enterprise as possible will be crucial to the chances for continuing a successful farming operation.

At a time when the margin of profit on many farm products is diminishing,¹¹³ size of the farming operation is extremely important. Preservation of the farm unit is crucial in a family farm situation, since the average size family farm is too small to be partitioned, and maintain the efficiency necessary for profitable operation.¹¹⁴ Therefore, family farm estate planners should carefully consider the feasibility of placing the farm in a revocable inter vivos trust. This device can provide for the farmer and his wife during retirement, and yet preserve the farm unit for an equitable transfer within the farm family.

In a revocable inter vivos trust arrangement, legal title to the farm property transferred in trust is placed in the trustee.¹¹⁵ Death of the settlor or a co-beneficiary under the trust does not affect legal title to this property.¹¹⁶ A revocable inter vivos trust can continue after creation for a period of time limited by statute or common law of the jurisdiction within which the trust is located.¹¹⁷ Through appointment of an institutional trustee whose existence will be assured for some time greater than that of the settlor, or by making provisions for a substitute trustee in the event the appointed trustee ceases to serve,¹¹⁸ the farm trust property can be maintained as a unit subsequent to the demise of the settlor or any beneficiary under the trust.¹¹⁹

If a family farm passes by will or intestacy, the heir who desires to continue the farm operation may not be in a position to immediately

instead of allowing the farm to remain in joint tenancy, total death taxes levied on the farm property may be reduced by as much as \$13,000. See Hines, *supra* note 22, at 600-01.

¹¹³ See U.S. DEP'T OF AGRICULTURE, AGRICULTURAL STATISTICS 1969, at 467-73.

¹¹⁴ See O'BYRNE, TIMMONS AND HINES, *supra* note 11, at 6-7.

¹¹⁵ See BOGERT § 1 at 4.

¹¹⁶ See I SCOTT § 8 at 75.

¹¹⁷ Statutes limiting the duration of an inter vivos trust are basically patterned after the Rule against Perpetuities. These statutes vary, however, both by their terms and court interpretation. See BOGERT § 218.

In Iowa, the limitation on duration of a trust is concerned with vesting of the beneficial interest in trust property. See *Butler v. Butler*, 253 Iowa 1084, 1128-29, 114 N.W.2d 595, 621 (1962). The interpretation of Iowa's statute, however, is unusual because the statute does not mention the word "vesting." See IOWA CODE § 558.68 (1966).

¹¹⁸ If no provisions for appointment of a substitute trustee are made within the trust instrument, a substitute will be appointed by the court. See II SCOTT § 101.

¹¹⁹ If a beneficiary dies prior to termination of the trust, his interest will pass by testate or intestate succession, unless the terms of the trust provide for this contingency. See BOGERT § 189.

purchase the interests of other heirs.¹²⁰ If he is devised an option to purchase the property at a lower price which he can afford, however, less fortunate heirs may be resentful. Through the terms of an inter vivos trust, the beneficiary who desires to continue farming can be granted an option to purchase the property at an appraised value over a period of time sufficiently long to avoid the necessity of going deeply in debt.¹²¹ During this period the other beneficiaries can share in their portion of the trust income.¹²² Although they may have to wait for some time before receiving their full share of the farm's value, reasonable equality among potential heirs can be achieved and the possibility of family conflict reduced.

An inter vivos trust of family farm property can probably never be employed as a complete will substitute. Property acquired by the farmer subsequent to creation of the trust will not automatically be transferred into the trust.¹²³ It is not practical, and probably would not be desirable in a family farm situation, to place the entire farm property in trust and transfer each newly acquired piece of property into that trust.¹²⁴ Thus, it is necessary to combine the trust with a will in order to complete the estate plan. In most states, through a provision of the farmer's will he can "pour-over" farm property not required for the payment of debts or taxes of his estate into the inter vivos trust.¹²⁵ In this way, equipment necessary to the farming operation can be placed within the farm-trust unit upon the farmer's death.

In some jurisdictions, it may not be possible to pour over into a revocable trust which has been altered since the settlor's will was written.¹²⁶ The better approach to this problem, however, would appear to be that adopted by the *Uniform Testamentary Additions to Trusts Act*.¹²⁷ The substance of this act has been accepted in Iowa¹²⁸ and at least 39 other states.¹²⁹ It allows pouring over into any trust created

¹²⁰ Average land prices in 1966 were estimated to be more than five times higher than in 1940. It has been predicted that a commercial family farm, by 1980, will represent an investment of over \$200,000. See Brooks, *Farms Are Big Business*, 46 TRUST BULL. 197 (1966).

¹²¹ See O'BYRNE, *supra* note 43, at 126.

¹²² See BOGERT § 181. The settlor can provide in the trust instrument for whatever percentage of the total farm income he feels should be allotted the beneficiary who is actually farming.

¹²³ See *id.* § 113.

¹²⁴ It would not be desirable to place all farm property in trust because, on the death of the settlor, the estate would be in a highly illiquid position. The liquidity problem is one which is present when planning most farm estates. The estate planner should encourage his client to have sufficient liquid assets available, e.g., life insurance and bona fide loans from the revocable trusts, to pay death costs. See Logan, *supra* note 43, at 330; O'BYRNE, TIMMONS & HINES, *supra* note 11, at 34.

¹²⁵ See T. ATKINSON, *supra* note 25, § 80, at 393; Marcus, *Pour-Over Provisions and Estate Planning*, 70 DICK. L. REV. 158, 159 (1966).

¹²⁶ See T. ATKINSON, *supra* note 25, § 80, at 393.

¹²⁷ This Act is reproduced in 9C UNIFORM LAWS ANN. 168 (Supp. 1967).

¹²⁸ IOWA CODE § 633.275 (1966).

¹²⁹ NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS 163 (1967).

by a decedent during his lifetime if it is functioning upon his death.¹³⁰ Thus, in many states the family farmer's estate planner may employ a revocable inter vivos trust and insert a pour-over provision in the farmer's will to accomplish his estate planning objectives.

4. *Minimizing Costs Generated by the Revocable Trust*

If one of a farmer's purposes for creating a revocable trust is to eliminate the burden of managing his farm, and he has no heirs who want to continue farming, accepting the costs of an institutional trustee is justified.¹³¹ In the typical family farm situation, however, when an heir wants to take over the farming operation, or when the farmer wants to continue managing the farm himself, paying a trustee is unnecessary. Instead of hiring an institutional trustee, the settlor may consider naming the heir who is assuming active farm operation as trustee to serve without fee. This arrangement is valid under trust law,¹³² but since the trustee would be his own employee it does create substantial self-dealing problems.¹³³ In addition, the farm owner should carefully examine his family situation before making such a transfer.

It would seem that the heir who is the trustee-operator of the farm may have an interest in persuading the settlor not to revoke the trust, even though such a revocation would be best for the settlor. Transfer in trust of the legal title to an heir who is not farming may cause the opposite type of problem. The heir who is not farming may not wish to wait to obtain his interest until his co-heir is in a position to make such a purchase. Thus, he may encourage the settlor to unnecessarily revoke portions of the trust and make it available for distribution, rather than preserving assets necessary for the farming operation within the trust. If the farm owner has a close friend who is willing to assume sufficient management duties to prevent the trust from becoming passive,¹³⁴ transfer of legal title to this person may be desirable.¹³⁵ A private agreement on trustee's fees could then be made which would probably save the settlor considerable expense.

¹³⁰ UNIFORM TESTAMENTARY ADDITIONS TO TRUSTS ACT § 1, 9C UNIFORM LAWS ANN. 167 (Supp. 1967).

¹³¹ See note 46 and accompanying text *supra*.

¹³² See BOGERT § 191, at 303.

¹³³ See, e.g., *In re Will of Gleeson*, 5 Ill. App. 2d. 61, 67, 124 N.E.2d 624, 627 (3rd Dist. 1955) (trustee leasing real estate to himself is guilty of self-dealing and liable for profits received); *Whitelock v. Dorsey*, 121 Md. 497, 502-03, 88 A. 241, 242 (1913) (trustee-beneficiary may purchase trust property only in unusual circumstances); *Anderton v. Patterson*, 363 Pa. 121, 125, 69 A.2d 87, 89 (1949) (trustee-beneficiary may be removed as trustee for using trust property for personal profit).

¹³⁴ A passive trust is "executed" by the Statute of Uses, which many states regard as part of the common law effective within the jurisdiction. See BOGERT § 206. Some states have statutes which produce a similar effect. See, e.g., Ill. ANN. STAT. ch. 30, § 3 (Smith-Hurd 1969); KAN. STAT. ANN. § 58-2413 (1964); MINN. STAT. ANN. § 501.04 (1947). Execution of a trust causes legal title in the trust property to pass directly to the trust beneficiaries. See BOGERT § 206.

¹³⁵ There are few restrictions on the possible individuals who can be named as

The settlor may be able to name himself as trustee of the trust property.¹³⁶ The essential requirements for creation of a declaration of trust are the same as those for transferring legal title to third-party trustee.¹³⁷ By naming himself as trustee, however, the settlor can avoid the expenses connected with a transfer in trust.

This form of revocable trust creates essentially the same relationship as a revocable transfer, and can accomplish the same objectives.¹³⁸ Its validity, however, is less clear, particularly when the trust contains real estate.¹³⁹ It is, therefore, necessary to analyse the differences between a revocable transfer and declaration of trust to determine whether there is a purpose for drawing this distinction.

The degree to which the settlor may reserve power to change terms of the trust can be no greater in a revocable declaration than in a revocable transfer in trust.¹⁴⁰ Thus, the beneficial interest created seems to be the same in both arrangements. The only real basis for distinguishing these forms would appear to be that in a revocable declaration of trust the settlor is also the trustee.

Since the settlor of a revocable declaration of trust is also the trustee, a more obvious situation of settlor control is presented. An argument could be made that a potential conflict of interest is present as a result of these dual roles.¹⁴¹ The settlor-trustee to a revocable declaration of trust may, of course, revoke portions or all of the trust. Such a power, however, does not appear to raise any greater conflict of interest questions than does reservation of the right to revoke a transfer in trust. In either case the settlor needs no justification for his actions.¹⁴² If the settlor reserves a right to income from the trust, it would seem that he would do everything possible to increase that income through conscientious trust management. In addition, with a more extensive knowledge of the potential of his farm, the settlor-trustee is probably better equipped than a third party to perform the duties of a trustee. It would appear, therefore, that no conceptual difference exists between these revocable trust forms.¹⁴³ Consequently, the better approach is to invalidate the arrangement only when necessitated by some affirmative public policy. When the settlor's purposes for creating a revocable

trustee over a farm trust. If a close friend of the settlor is not suffering from some legal disability, such as insanity, he can serve as trustee. See II SCOTT § 89.

¹³⁶ See RESTATEMENT (SECOND) OF TRUSTS § 17 (1959); I SCOTT § 17.1.

¹³⁷ See authorities cited note 136 *supra*; cf. BOGERT § 141.

¹³⁸ See Marks, *The Revocable Declaration of Trust*, 105 TRUSTS AND ESTATES 1141, 1144 (1966).

¹³⁹ See I SCOTT § 28.1; Marks, *supra* note 138, at 1144.

¹⁴⁰ In most jurisdictions, the settlor of a revocable transfer in trust can reserve a right to receive income generated by the trust, plus the power to alter, amend or revoke at any time. See authorities cited note 80 *supra*.

¹⁴¹ See Marks, *supra* note 138, at 1146.

¹⁴² See BOGERT § 993, at 431; IV SCOTT § 331, at 2619.

¹⁴³ The trend appears to be to uphold the validity of a revocable declaration of trust. See, e.g., *United Building & Loan Ass'n v. Garrett*, 64 F. Supp. 460, 466 (1946) (applying Arkansas law); *Farkas v. Williams*, 5 Ill. 2d 417, 432-33, 125 N.E.2d 600, 608 (1955); *Ridge v. Bright*, 244 N.C. 345, 352-53, 93 S.E.2d 607, 613 (1956).

declaration of trust are among those previously discussed, there should be no reason to defeat those goals.

B. *The Illinois Land Trust*

The Illinois Land Trust¹⁴⁴ is substantially different in form from those inter vivos trusts previously discussed. Essentially, a revocable trust is created with the trustee holding legal title to the trust property, but having very minimal duties to perform.¹⁴⁵ Beneficiaries under the trust control all operations and management decisions concerning the trust property.¹⁴⁶ Consequently, trustee's fees are small enough that any size farm could be placed in such a trust without impairing the settlor's financial position.¹⁴⁷

Since the trustee performs no active duties over the trust property, this form of trust would probably be held passive in most states.¹⁴⁸ It would appear that in only three states validity of this trust form is favorably settled.¹⁴⁹ The extent to which the Illinois Land Trust is presently being employed, therefore, seems to be quite restricted. Absent legislative authorization for this form of inter vivos trust the estate planner would probably be wise to avoid its use.¹⁵⁰ As a minimum, he should carefully review court decisions in his jurisdiction to determine the extent to which a trustee must be given active duties over trust property.¹⁵¹

If authorized by statute, however, this trust form could lower, or perhaps eliminate, the need for employing the present forms of revocable trusts to accomplish a family farmer's estate planning objectives. Since in the family farm situation one of the farm owner's heirs is to continue the farming operation, there is no need for a trustee to perform active managerial duties. In addition, one of the family farmer's chief estate planning objectives, preservation of the farm unit, may be achieved through use of this trust. One of the problems presented by present forms of revocable trusts—whether reservation of powers by the settlor-farmer creates an invalid testamentary disposition—would be avoided.

¹⁴⁴ The label for this form of trust is derived from the fact that its validity was first upheld by an Illinois court. See *Jennings v. Kotz*, 299 Ill. 465, 472, 132 N.E. 625, 630 (1921); *McKillop, The Illinois Land Trust in Florida*, 13 U. FLA. L. REV. 173 (1960).

¹⁴⁵ See *Higgenbotham, The Illinois Land Trust: Trust Business Producer and Problem Solver*, 46 TRUST BULL. 204-05 (1966).

¹⁴⁶ *Id.*

¹⁴⁷ The minimum annual fee, which would probably be paid by a small farm owner appears to be \$15. *Id.* at 205.

¹⁴⁸ Cf. *McKillop, supra* note 144, at 200.

¹⁴⁹ In addition to Illinois, Florida and Virginia have authorized this form of trust by statute. FLA. STAT. ANN. § 689.071 (1969); VA. CODE §§ 6.1-.345-.351 (1966); *Higgenbotham, supra* note 145, at 207.

¹⁵⁰ See *McKillop, supra* note 144, at 200.

¹⁵¹ The extent to which a trustee must be given active duties varies from state to state. See I SCOTT §§ 69.1-.2.

V. CONCLUSION

It is apparent that no single form of inter vivos trust can solve all problems presented when planning farm estates. The farm owner must determine an order of priority among his objectives. Once this has been done the estate planner can explain the alternative methods for accomplishing his objectives and the benefits which employment of an inter vivos trust affords.

A majority of farm owners would probably prefer creating a revocable trust for a farm upon which they must rely to generate retirement income, due to the degree of control which the owner may retain over assets placed within a revocable trust. As his circumstances permit, the owner could make permanent pre-death dispositions of portions of his farm property to reduce death tax liability. The Illinois Land Trust appears to offer substantial estate planning potential, if such an arrangement is valid within the jurisdiction.

It cannot be overemphasized that an inter vivos trust should not be used as an attempted will substitute. However, as a supplement to a will this trust is undoubtedly one of the most effective tools an estate planner has at his disposal. It appears that advantages offered by inter vivos trusts have not been employed as extensively in planning farm estates as their potential for problem solving would indicate.¹⁵² The farm estate planner should consider this potential before deciding how he can best accomplish the objectives of his client.

¹⁵² Cf. O'Byrne, *supra* note 43, at 126. There are, of course, various other inter vivos arrangements which can be employed to supplement a will when planning farm estates. The wisdom of using one arrangement over another depends upon the objectives and circumstances presented by the farm owner. For a discussion of alternative inter vivos arrangements, see Eckhardt, *Family Farm Corporations*, 1960 Wis. L. Rev. 555; White, *Intra-Family Land Transfers*, 39 N.D.L. Rev. 283 (1963).