Estate Planning Principles

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Agricultural Business Management

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Introduction:

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

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

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

Who Needs an Estate Plan?

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

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

Property Ownership:

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

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

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

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

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

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

Ownership by Contract allows transfer of assets upon the occurrence of a stated event such as the death of the owner. This method of ownership is not subject to the probate process and the asset is not subject to the decedent's Will or trust. The accounts are titled as Pay on Death (POD)-checking & savings accounts and CDs. Transfer on Death (TOD)-for investment accounts, car, boat, etc. and Transfer on Death Deed (TODD)-real property.

Life Estates are another method of transferring property.

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.

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 dies and passes land to his children, but with a life estate (life use) to his wife, the children are the remainderman and the wife is the life tenant. The wife receives all income from the property and must manage, maintain and pay all property expenses on it during her lifetime. Upon her death, the property passes outright to the children without being included in her estate. The property would receive a stepped up basis (valued at fair market value) on the date of the death of the husband.

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

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

Probate/Non-Probate Assets:

The probate process is established to prove that the decedent's Will is valid, to pay any debts held by the estate, to establish clear title to any assets, and to pay any necessary income or estate taxes. Solely owned property and property owned as tenants-in-common are subject to the probate process. Joint tenancy property, life insurance not owned by the decedent going to beneficiaries other than the estate, POD-TOD-TODD, and revocable living trust property are not subject to the probate process.

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

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

Federal Gross Estate:

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

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

Federal Estate Tax Exclusion		
Year	**Exclusion**	**Credit**
2013	$5,250,000	$2,045,800
2014	$5,340,000	$2,081,800
2015	$5,430,000	$2,117,800
2016	$5,450,000	$2,125,800
2017	$5,490,000	$2,141,800
Gift Tax Exclusion		
Year	**Exclusion**	**Credit**
2013	$5,250,000	$2,045,800
2014	$5,340,000	$2,081,800
2015	$5,430,000	$2,117,800
2016	$5,450,000	$2,125,800
2017	$5,490,000	$2,141,800

NOTE: Each person has **one** lifetime federal exclusion amount in any given year. You decide how you want to spend the exclusion amount. That is, you can use it to offset estate tax or gift tax. You do not have two separate exclusion amounts. Assets passing through one's estate in 2013 and beyond will receive a step up in basis.

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

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

Deductions from Federal Gross Estate:

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

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

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

Federal Estate & Gift Tax Rates:

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

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

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

Minnesota Estate Tax:

The 2017 MN Legislature changed the individual per person MN estate tax exclusion amounts. The exclusion amount represents the dollar amount of estate value you can pass to your heirs without any MN estate tax. The rates are effective for estates of decedents dying after December 31, 2016. Applicable rates are as follows:

2017 - $2,100,000 per person
2018 - $2,400,000 per person
2019 - $2,700,000 per person
2020 - $3,000,000 per person thereafter

Note: This estate tax exclusion amount subtraction cannot reduce your Minnesota estate to less than zero.

Corresponding tax rates also changed and are categorized into two categories: decedents dying in 2017 and decedents dying in 2018 and thereafter.

-For estates of decedents dying in 2017:
Tax rate is 12% for estate not over $5.1 million. The rate increases and for estates $10.1 million or over the rate is a maximum of 16%.

-For estates of decedents dying in 2018 and thereafter:
Tax rate is 13% for estate not over $7.1 million. The rate increases and for estates over $10.1 million or over the rate is a maximum of 16%.

The new MN estate tax rates take effect for decedents dying after December 31, 2016.

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

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

On July 20, 2011 the Governor of Minnesota signed into law the Minnesota Qualified Small Business Property and Qualified Farm Property Exclusion. The new legislation allows for a MN estate exclusion for qualified small business and farm property. The property must meet all the qualifications and cannot exceed the exclusion amounts mentioned in the previous paragraph. This exclusion is in addition to the MN personal estate tax exclusion outlined above.

Qualifications for farm property

To qualify, the property must meet the following criteria:

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

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

Qualifications for small business property

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

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

Qualified family member/heir

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

Recapture tax

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

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

The recapture tax equals 16 percent of the amount of the exclusion and must be paid to the Minnesota Department of Revenue within six months after the date of the disqualifying disposition or cessation of use. **Note:** new from the 2017 legislative changes, the recapture tax does not apply to the acquisition of title or possession of the qualified property by a federal, state or local government unit, or any other entity with the power of eminent domain for a public purpose within the three year holding period. This is effective for estates of decedents dying after December 31, 2016.

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

Information Returns:

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

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

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

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

Minnesota Gift Tax:

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

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

Special Use Valuation (SUV):

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

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

Example: Land is appraised at $5,200 (FMV) per acre with real estate taxes of $450 per acre, average cash rent of $200 per acre, and the FCB average effective interest rate of 4.87 percent (MN). The SUV calculation is as follows:

$$\frac{\$200 \text{ rent} - \$45 \text{ RE tax}}{.0487 \text{ FCS interest}} = \frac{\$155}{.0487} = \$\,3{,}183\text{/acre SUV}$$

Using the SUV on this land could save estate taxes on the value of $2,017/acre (Note: there are limits on the total dollar amount of reduction-see your attorney or accountant).

To find the Farm Credit System interest rates go online and search by "Farm Credit Bank Interest Rates". MN is included in the AgriBank FCB System list.

Note:

1) SUV should not be used on estates that are less than the Applicable Exclusion Exemption for the year in question. Doing so may result in a lower than necessary tax basis as well as unwanted rental and sale restrictions.

2) The business must be in compliance with the SUV rules for 10 years or you lose the SUV designation. The recipient must farm the land for 10 years - that means materially participating by farming the land or farming on shares and having financial risk. The person cannot rent the land to someone else for cash - that violates the SUV conditions.

3) To qualify the decedent's estate must have included at least 50% ag assets and at least 25% farm land.

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

Power-of-Attorney (POA):

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

Power-of-Attorney categories:

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

2) Statutory Short Form Power of Attorney powers are governed by state law and are generally very broad. Powers can be changed at any time by legislative law change. Powers typically take effect immediately and there is a $10,000 gifting limit per person in MN. In MN, after June 1, 2104 all former statutory short forms become common law power of attorney. In addition, a new ruling allows any government agency to require an accounting of the "attorney in fact" (person who is power-of-attorney) for anything they are doing financially on behalf of someone else.

3) Durable Power-of-Attorney Both Common Law and Statutory Powers-of-Attorney can be durable. Durable means the powers will continue to be

affective after disability. If an individual does not have the durable form of POA and becomes incapacitated or disabled, the courts will appoint a new POA.

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

Health Care Directive:

A Health Care Directive allows one to decide what level of health care you want if you become disabled or death is eminent. You can list whether or not you want to be kept alive or not. You can list if you want to be an organ donor. You can outline your funeral in the document as well. It is a binding contract document that family members and health providers must follow.

HIPAA Designations:

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

It is encouraged to include in your HIPAA documents what is referred to as a HIPAA personal representative. This is an individual or individuals that can sign a health care directive on your behalf. Consider listing more than one person and they would include your spouse, your children, your grandchildren, etc.

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

A very simple way of carrying your health care directive with you 24/7 is to have it sent to a company such as Legal Directives, Docubank, US Living Will Registry, Legal Vault, etc. where it is placed into the company's electronic database. They will then issue you a card similar to your insurance card. On the back of the card is an 800 number that medical personnel can call and get a copy of your health care directive FAXED to them. Many attorneys do this for their clients or you can do it for yourself. It is relatively inexpensive for being able to in essence carry your health care directive with you at all times.

Disability panel:

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

Summary:

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

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

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

For more details see the following information sheets in this series:
Estate Planning Series #3-Establishing a Will
Estate Planning Series #5-Revocable Living Trusts.
Estate Planning Series #12-Maintaining Farm Land Homestead Classification and Qualification for Minnesota Qualified Small Business Property Qualified Farm Property Exclusion.

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