

Estate Planning Bulletin

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Estate Tax Update by Wade R. Wacholz

The Federal/Minnesota Gap

On January 1, 2009, the total amount a person could pass from their estate without paying federal estate tax increased from \$2 million to \$3.5 million. The increase was part of a phased-in series of increases passed with the 2001 tax reform legislation. Absent further action by Congress, the federal estate tax is set to be repealed in 2010, for one year. In 2011, the 2001 tax reform legislation "sunsets" and the estate tax reverts to its pre-2001 levels, meaning that all estates in excess of \$1 million will be subject to the tax.

When the federal estate tax laws were changed in 2001, Minnesota "decoupled" its estate tax from the federal plan, so the state still imposes a tax on estates which exceed \$1 million in value. Because the "gap" between the Minnesota and federal estate taxes is now \$2.5 million, it is of increasing importance to pay careful attention to tax provisions in your estate plan.

A principal goal is to assure that the minimum amount of estate transfer taxes is payable. The amount of tax due, if any, is based on the value of all estate assets, including the home, other real

estate, retirement accounts, death benefits paid under life insurance policies, and all other assets. Some points to consider are:

- Where the total value is less than \$1 million no estate tax will be due, therefore basic planning is all that is required.
- Where total asset values exceed \$3.5 million, both federal and state estate taxes will be due. The federal rate is 45% and the state rate varies with the size of the estate but is in the range of 8%.
- For married taxpayers, appropriate steps should be taken to assure that a

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Funeral and Burial Funds, Trusts, and Life Insurance by Daniel A. Beckman

The state and federal requirements to qualify for various forms of medical assistance can be extremely restrictive. Public assistance recipients are only allowed to keep minimal assets in order to qualify, and state and federal agencies are permitted to "look back" for a number of years at any transfers to family members which potentially can be reversed. One area of planning that may provide some financial assistance to family members and heirs while still permitting the grantor to qualify for public assistance, is funeral and burial expense plans and insurance. Several different types of plans and exclusions are potentially available to an individual.

Burial spaces and burial

space items held for use by the medical assistance applicant, his or her spouse, and any member of the immediate family are excluded as an asset regardless of who owns them. There is no dollar limit for these items. "Burial space" is defined to include a conventional plot, gravesite, crypt, mausoleum, vault, casket, urn, etc. "Burial space items" are items used for the disposal of the body after all funeral services and mortuary functions have taken place, including the opening and closing of the grave, the headstone, urn, etc. "Immediate family" includes the applicant's minor and adult children, step-children, adopted children, brothers, sisters, adoptive stepbrothers

and sisters, parents, adoptive parents, and spouses of any of these persons.

Any agreement, whether revocable or irrevocable, that results in the individual's rights to a burial receptacle being held for the individual is subject to the burial space exclusion.

Another avenue available for individuals is the prepayment of funeral expenses using a life insurance policy or annuity. The purchase of a life insurance policy or an annuity to pay for burial funds is considered a transfer of assets subject to the look-back period, unless the policy or annuity names "funeral home as its interest may appear" as the irrevocable beneficiary and the estate of

the individual as the irrevocable contingent beneficiary. It must also be accompanied by a contract with the funeral home specifying the amounts to be paid for services and burial space items, and the amount paid for the policy or annuity does not exceed the amount of the contract. Again, there is no limitation as to the amount spent either for burial funds or for burial space items as long as the other requirements are met.

"Burial funds" are defined as funeral arrangements and services that include transportation of the body, embalming, cremation, funeral or memorial services, flowers, clothing, etc., and

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QPRs & IRAs: Effective Tax and Estate Planning Tools

by Reed H. Glawe & Mary Kay Mages

While primarily associated with retirement planning, Qualified Retirement Plans (QPRs) and Individual Retirement Accounts (IRAs) are also powerful estate planning tools and wealth transfer vehicles when structured correctly.

QRP refers to any plan meeting specific Internal Revenue Code requirements and as a result is eligible to receive certain tax benefits. The most common QRPs are 401(k) plans and profit sharing plans established by employers for the benefit of their employees. For self-employed individuals, or employed individuals doing additional retirement planning, an IRA established by the individual for the individual's own benefit offers the same tax advantages as a QRP. The individual for whose benefit either a QRP or an IRA is established is known as the "plan participant." The contributions to either a QRP or an IRA (along with any increase in value of those contributions) are known as the "plan account."

QRPs and IRAs are tax deferral plans, not tax avoidance plans. The plan participant does not pay income taxes on either contributions to the plan account or the increases in the plan account. Distributions from the plan account (whether distributed to the participant or some other beneficiary) are taxed as income at the time of distribution.

To maximize the wealth transfer possibilities inherent in both QRPs and IRAs, one should try to postpone

withdrawals from the plan account for as long as possible. This allows the account's earnings to continue to accrue while the income tax is being continually deferred into the future. There are two hindrances to this basic strategy. The first hindrance is unavoidable: federal law requires plan participants to take minimum withdrawals from the plan account beginning at age 70 ½ and for the rest of the plan participant's life. The second hindrance, however, can be minimized or avoided with careful planning: following the plan participant's death, assuming there is still money left in the plan account, the balance will be distributed to the plan participant's named beneficiary either 1) within five years of the plan participant's death or 2) on a timetable that is based on the plan participant's life expectancy, *unless* the life expectancy used for purposes of distributions is the beneficiary's life expectancy.

The law does allow for distributions to be based on a life expectancy of someone other than the plan participant in the following three instances: 1) the beneficiary is a specifically named individual (if the beneficiary is someone other than the plan participant's spouse, the spouse must sign a waiver to make such a designation effective), 2) the beneficiary is a class of individuals from among whom the individual with the shortest life expectancy is capable of being identified, or 3) the beneficiary is a trust the beneficiary of which is either a named individual or

a class of individuals from among whom the individual with the shortest life expectancy is capable of being identified. The rate at which distributions from a QRP or IRA must be made, and consequently income tax liability incurred, can be stretched out if a qualified beneficiary with a long life expectancy is selected.

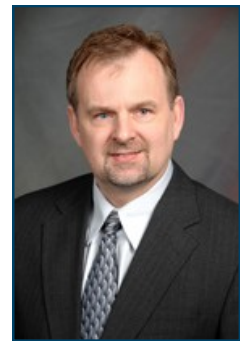
Naming a trust as the beneficiary of a QRP or IRA also has estate planning advantages.

Consider naming a trust as the QRP or IRA beneficiary for the same reasons you might otherwise consider trusts for estate planning purposes:

1. If the plan participant's intended beneficiary is a person receiving government benefits. Naming a qualifying trust as a beneficiary rather than the person individually may preserve the person's eligibility for government benefits.
2. If the plan participant's intended beneficiary is a second spouse, the plan participant may want to limit the second spouse's access to the trust principal.
3. If the plan participant's intended beneficiary is a minor or other individual incapable of managing finances, the trust provides a level of management.
4. If the plan participant and spouse have a taxable estate, credit shelter trusts can preserve and maximize the available estate and gift tax exemption of both spouses.

5. If the plan participant desires to make charitable contributions, some carefully structured trusts can accomplish charitable goals while basing distribution requirements on an individual with a long life expectancy.

Even if QRPs and IRAs were established with retirement in mind, it is never too late to use QRPs and IRAs to transfer wealth to the next generation or to achieve tax saving and estate planning.



Reed Glawe joined the firm in 1980. Reed helps clients with farm and small business transitions. He is based in our New Ulm office.



Mary Kay Mages also works in our New Ulm office. She has been with Gislason & Hunter since 2000. Her specialties are Agricultural law and Elder law.

Estate Tax Update cont'd

"credit-shelter" trust is in place so that the full amount of the federal exemption is used for each person and applicable estate tax credits are not wasted. This allows up to \$7 million to be passed to the next generation without federal tax.

- For Minnesota residents (or those with assets located in Minnesota, such as real estate), the "decoupling" of Minnesota estate taxes means that, on estates of greater than \$1.0 million, Minnesota estate tax will be due.
- For estates of a value between \$1 million and \$3.5 million, individuals will want to adjust their planning so as to minimize Minnesota estate taxes, even in a situation where there may be no federal estate tax. This may

mean updating your documents if they were done before the 2001 "de-coupling" of Minnesota and federal tax laws.

Otherwise, in estates exceeding \$1 million, it is possible to have zero federal estate tax but a significant Minnesota estate tax. It is particularly important to address this planning issue with joint estates where the husband and wife together own between \$1 million and \$2 million.

Proper planning can pass a full \$2 million free of any estate tax. Inattention to such details could result in up to \$90,000 in additional Minnesota taxes being due.

Interested individuals should consult with their estate planning professional at Gislason & Hunter to review the status of their documents, and update their plans to maximize tax

benefits in light of current law.

Changes on the Horizon

Congress and the White House have a very full plate, but tax law changes are definitely on the menu. Under current law, the estate tax is set to be eliminated in 2010, but only for that year. In 2011, the estate tax regime is "reset" to its pre-2001 levels. For a variety of reasons, the conventional wisdom is that Washington will pass some legislation, perhaps later this year, which eliminates this form of legal "whiplash."

Most estate planning and tax professionals anticipate that a tax reform bill will keep the current \$3.5 million estate tax exemption amount and a top rate of 45%. There is somewhat less confidence about various other so-called "loopholes," including recent suggestions about changes to the rules regarding valuation of estate assets.

Stay tuned throughout the fall as the proposals work their way through Congress. A year end review with your estate planning professional will likely be helpful to determine whether changes in your plan need to be considered.



Wade Wacholz has been with Gislason & Hunter since 1987. He has extensive experience in Estate Planning, Real Estate and Business transactions. Wade is based out of our Minneapolis office.

Funeral and Burial Funds, Trusts, and Life Insurance cont'd



Dan Beckman came to Gislason & Hunter in 1988. He works with clients on a broad range of business issues, including planning, real estate, organizational structure, contract and litigation. Dan works in our Minneapolis office.

are distinguished from burial space items that are used for interment of the decedent's

remains. Amounts up to \$1,500 in a revocable burial fund for funeral services or mortuary functions are excluded from assets available to satisfy any medical assistance liens.

Another option available to individuals is an irrevocable funeral trust up to a maximum of \$2,000 per person for any applicant. If an irrevocable funeral trust includes burial spaces and funeral services, the value of the burial space can be excluded under the burial space exclusion only if the item and its value are specifically identified in the agreement. Burial funds may be liquid or non-liquid assets, including bank accounts, contracts, the cash

surrender value of life insurance policies, personal or real property, trusts, or any other asset that has value.

There are a few life insurance companies that offer qualifying insurance contracts under Minnesota law. As a result of various perceived abuses, the Minnesota Legislature has recently made certain amendments to the specific requirements of such plans. The specific requirements of such insurance policies or pre-need funeral trusts are beyond the scope of this article. If contemplating such an arrangement, however, make sure that the appropriate legal requirements are met to take

advantage of all of the benefits of such an arrangement.

In conclusion, when faced with the situation where a family member who needs public assistance for medical or personal care, but does not have sufficient time to avoid the look-back periods under state and federal law (which can be up to six years), one area that may be available to shelter certain assets and provide assistance with the ultimate funeral and burial expenses can be life insurance, burial funds and burial space plans.

Please feel free to contact us should you wish to discuss any of these

Our Estate Planning Attorneys:

C. Thomas Wilson

Marlin R. Kunard

Reed H. Glawe

Wade R. Wacholz

Andrew A. Willaert, Jr.

Daniel A. Beckman

Sara N. Wilson

Mary Kay Mages

Lynn Schmidt Walters

Office Locations:

New Ulm
507-354-3111

Minneapolis
763-225-6000

Mankato
507-387-1115

Mapleton
507-524-3812

Des Moines
515-244-6199

www.gislason.com

Wills, Trusts, Estate Planning, & Probate

Estate planning is important to ensure the orderly transfer of family assets, as well as to protect those assets from unnecessary taxation. We can assist with pre-death planning and transfers, as well as making the decisions as to what type of estate structure is best for you and your family.

Good planning requires expert legal advice. Without it, the potential or unintended gifts, unnecessary taxation, and family discord increases immeasurably.

We can help you create an estate plan that will preserve your legacy. Depending on your circumstances and intentions, our advice and work can range from simple wills to complicated trust instruments.

Our attorneys offer the following services:

- Drafting wills, trusts, codicils, and Powers of Attorney
- Preparing Health Care Directives and Living Wills
- Creating Family Business Succession Plans with emphasis on each family's particular goals and values
- Evaluating estate and gift tax issues and structuring planning options to minimize tax obligations
- Administering and assisting clients with probate proceedings, conservatorships, and guardianships
- Advising on Medicaid, Medicare, Nursing Home and Elder law issues
- Handling disputed estate and probate matters in litigation, arbitration, or mediation formats

Gislason & Hunter LLP Attorneys at Law

We have built a thriving practice based on achieving our clients' goals with expertise, integrity, and a healthy measure of common sense. We understand that there is no substitute for hard work or fairness. This is the way we work and the way our clients want things done. We understand that it is the best way to get results.

Gislason & Hunter is a law firm dedicated to meeting the needs of businesses and individuals. We are a law firm that handles complex cases worth hundreds of millions of dollars, mediates settlements, and negotiates and drafts complex transactional documents.

With offices in Iowa and Minnesota, we are at home in both rural and metropolitan areas. Most of our attorneys were born and raised in the Midwest; all are deeply committed to the communities where they live and work.

We have built our practice by achieving client's goals. Experience the difference of working with an experienced, practical law firm that will get you results.

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