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Estate Planning BULLETIN

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ESTATE PLANNING FOR SECOND MARRIAGES QTIP TRUSTS

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For estate tax purposes, property which passes to a decedent's surviving spouse is not subject to gift or estate tax. In general, however, full ownership of this property must actually pass to the surviving spouse. An exception to this general rule is a transfer through a QTIP trust (short for "Qualified Terminable Interest Property").

Tax Effect: Under the federal tax code, property is treated as passing to the surviving spouse, as long as the surviving spouse has a lifetime income interest in the property. A QTIP trust is often used to take advantage of that "marital deduction", yet still control the ultimate distribution of the assets to a third party at the death of the surviving spouse. The assets qualify for the unlimited marital deduction, which lets all property pass to a surviving spouse free of estate tax. While a QTIP trust doesn't eliminate estate tax, it is postponed until the death of the second spouse, because at that time estate tax is due on all of that spouse's property, including assets held in a QTIP trust.

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ESTATE PLANNING FOR SECOND MARRIAGES – QTIP TRUSTS

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Benefits for Surviving Spouse: Each spouse can set up a QTIP trust leaving assets to the other in trust. When the first spouse dies, the survivor receives a "life estate" in the assets that are left to the QTIP trust. That means the survivor is entitled to any income the assets produce and, in the case of real estate, to its use. Only the surviving spouse can be named as the life beneficiary. The survivor does not, however, have full ownership of the trust assets and cannot sell them or give them away. When the second spouse dies, trust assets go to the "final beneficiary" named in the trust.

Final Beneficiaries: Commonly, the final beneficiaries are children from the other spouse's previous marriage or, in some cases, grandchildren.

Previous Marriage: QTIP trusts are often used when a spouse has children from another marriage. The other spouse may wish to provide for this spouse and take advantage of the spouse's unified credit against gift and estate tax, but nonetheless designate where the money will go after that spouse is deceased. A QTIP trust allows this to be accomplished in a manner treated as a gift to a spouse.

Example: Aaron establishes a QTIP trust naming his wife Jennifer as the life beneficiary in their home and some investment accounts. Aaron's sons from a previous marriage are the final beneficiaries. Aaron dies first, leaving Jennifer a life estate in the house and investment assets. While she cannot sell, gift or bequeath those assets at her death, she receives the income from the accounts and has the right to live in the house. At her death, the assets will pass to Aaron's sons.

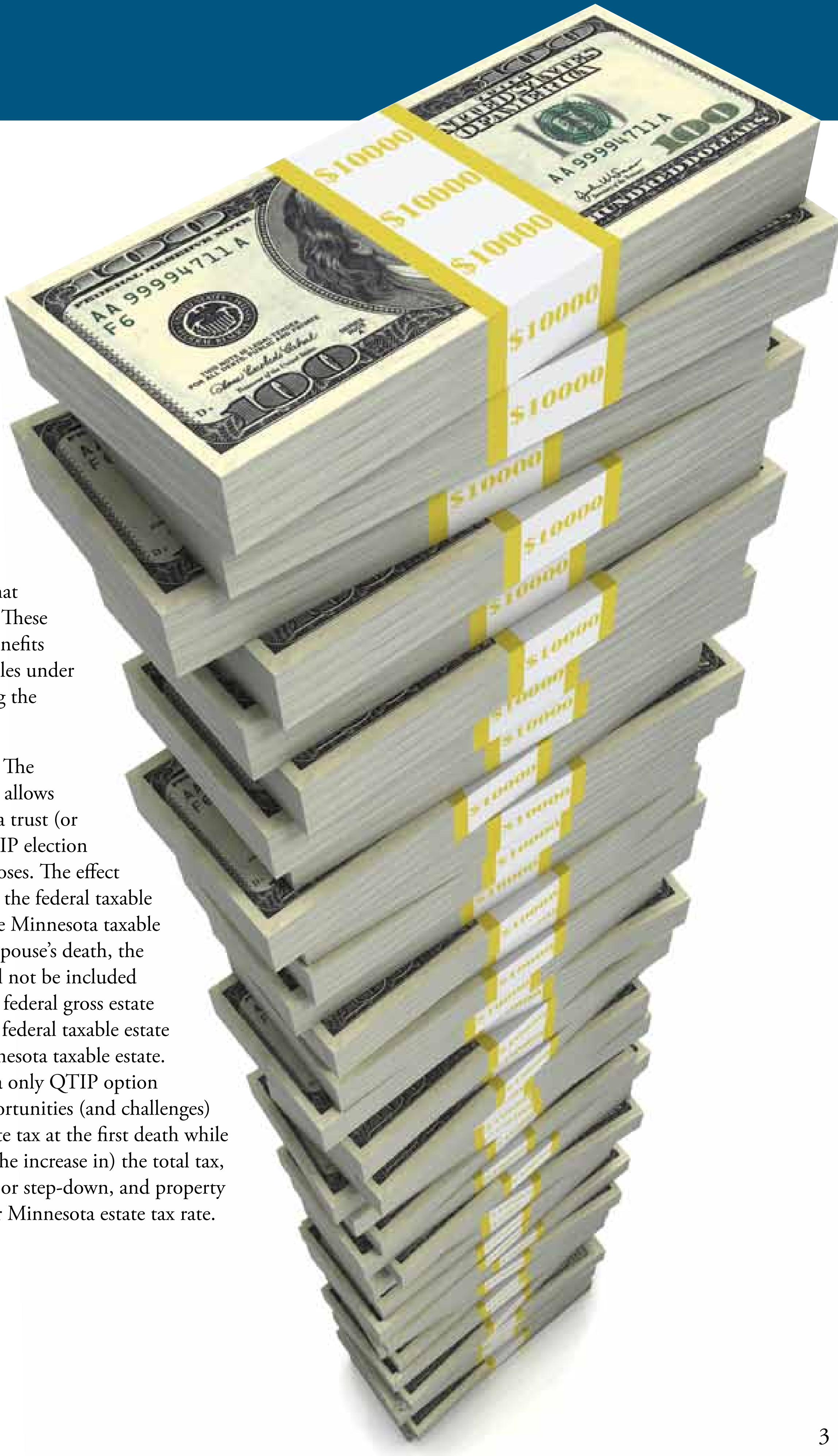
Demonstrating to children that they will ultimately inherit assets can be a good way to reduce family tension in the case of a subsequent marriage. When arrangements are laid out in a solid estate plan, the children can relax. They needn't be afraid that a stepparent will squander the family inheritance, leave it all to his or her own relatives, or remarry and leave it to a new spouse.

Grandchildren: If Grandma gives $100,000 to Grandpa, this is a gift to a spouse, exempt from the gift and estate tax. However, if Grandma were to give the $100,000 to Grandson, this would be included for gift and estate tax purposes. Instead, Grandma can place this $100,000 in a QTIP trust which will make payments of money to Grandpa during his life, and have the money in the trust pass to Grandson when Grandpa dies. This is treated as a marital gift to Grandpa, exempt from the gift and estate tax, to the extent of any property he received. The amount passing to the Grandson upon the death of Grandpa will be included in Grandpa's estate for estate tax consideration.

Flexibility: Another feature of a QTIP trust is the flexibility it can provide for the surviving spouse. If at the first spouse's death, the family's financial situation – or estate tax laws – has changed since the trust was drawn up, the survivor need not implement it. The decision is officially in the hands of the person you name in the will, who may or may not be the surviving spouse. To actually create the QTIP trust, the personal representative must make a "QTIP election" on the estate tax return that's filed for the estate of the first spouse to die.

Same sex marriage: Since June 2013 when the U.S. Supreme Court found parts of the federal Defense of Marriage Act (DOMA) unconstitutional, the IRS has recognized legal marriages of same-sex couples, regardless of what state the couples live in. These couples may claim all benefits granted to married couples under federal tax law, including the marital deduction.

Minnesota only QTIP: The Minnesota 2014 tax law allows for a QTIP election for a trust (or property) even if no QTIP election is made for federal purposes. The effect will be a reduction from the federal taxable estate in determining the Minnesota taxable estate. At the surviving spouse's death, the property in the trust will not be included in the surviving spouse's federal gross estate but will be added to the federal taxable estate in determining the Minnesota taxable estate. However, the Minnesota only QTIP option provides additional opportunities (and challenges) to avoid Minnesota estate tax at the first death while minimizing (or at least the increase in) the total tax, such as no basis step-up or step-down, and property may be subject to higher Minnesota estate tax rate.



ROGUE FIDUCIARIES

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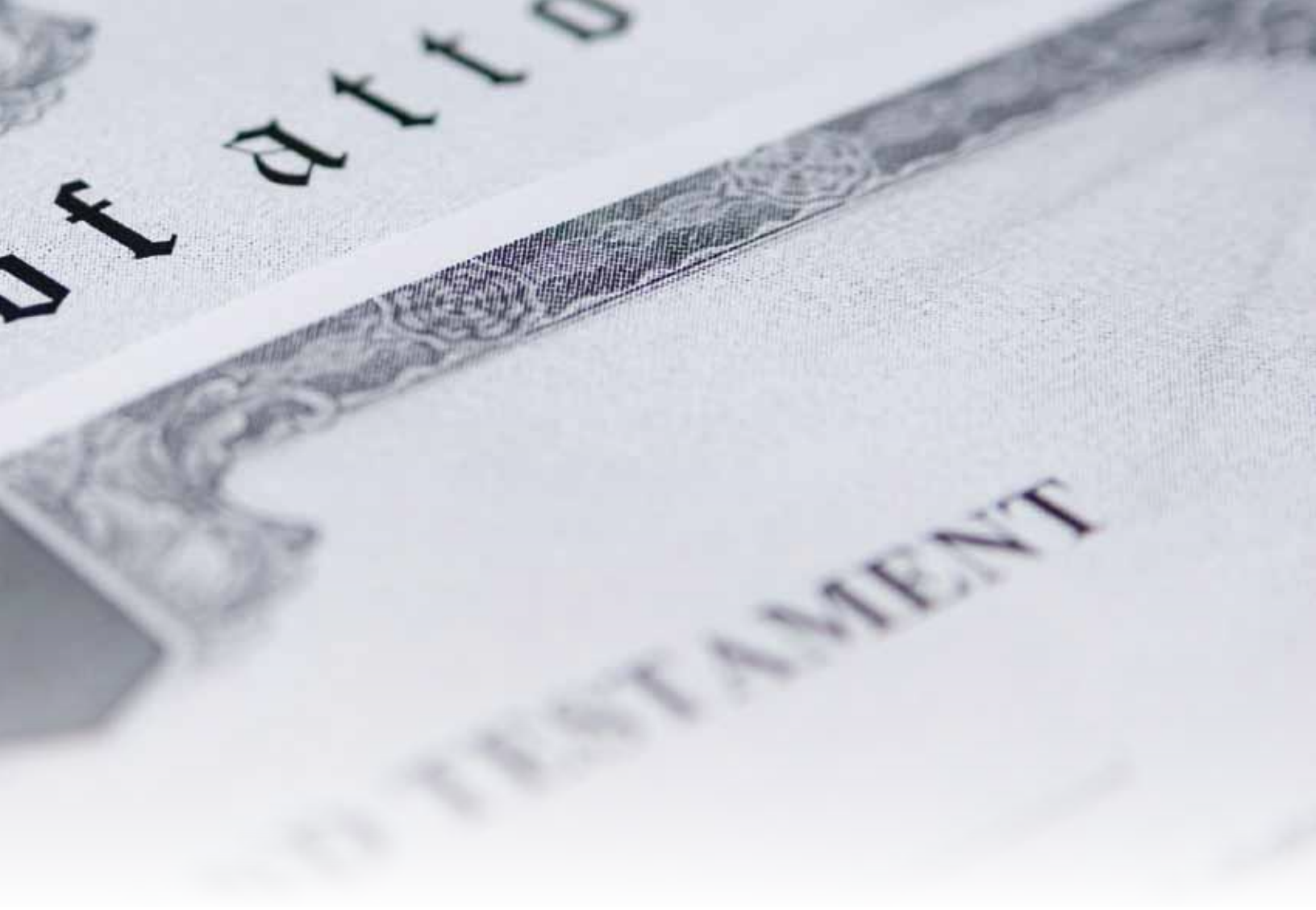
From time to time our office becomes involved in disputes where someone was appointed to serve in a fiduciary position of trust and loyalty only to have the fiduciary end up having their own ideas of what is appropriate and proper for the person who made the appointment. Fiduciary is derived from Roman law and means a person holding a position of confidence and scrupulous good faith and candor which the position requires. It is analogous to a trustee or someone who is in a position of trust relative to someone else. Fiduciary positions include a personal representative of an estate, a trustee of a trust, an attorney-in-fact, a custodian, and others. They owe a duty of loyalty to others when exercising their powers. These fiduciaries are oftentimes sons or daughters, sisters or brothers, in-laws, bank trust departments, friends, or business acquaintances, to name a few. On occasion, an individual fiduciary, who seemed to be a good choice at the time of selection, ends up having different ideas about what is best for the person to whom the duty of loyalty is owed, and depending on the type of fiduciary, it is not always easy to correct the conduct or have them removed. Changes to the applicable laws in recent years have provided some possible remedies.



Power of Attorney. A power of attorney is a document in which a person (i.e., principal) executes a document authorizing someone else (i.e., attorney-in-fact) to act on behalf of the principal. These types of authorizations can range broadly in scope, from engaging in real estate transactions, banking, financial or business matters, to entering into contracts, making gifts and other types of activity. The idea is that the attorney-in-fact essentially steps into the shoes of the principal, and like the principal, engaging in these types of activities is nobody's business other than the principal's. So it has been the case when the attorney-in-fact engages in these activities on behalf of the principal. Where the principal was an incapacitated or incompetent parent and the attorney-in-fact was a son or daughter, it oftentimes is frustrating for other siblings, friends or family members to keep tabs on the attorney-in-fact and make sure he or she is engaging in activities primarily for the benefit of the principal, not for the personal benefit of the attorney-in-fact. However, because of privacy rules, it has been very difficult, if not impossible, for these other interested persons to force disclosure; the attorney-in-fact could and oftentimes did say "it's none of your business," and that was that. In 2013, the Minnesota legislature made a number of revisions to the power of attorney statute (i.e., Chapter 523), and one of the provisions which was added allows "interested persons" to petition the court for a protective order directing an attorney-in-fact to provide an accounting or for any other

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relief as the court deems appropriate. Interested persons include not only the principal, but also spouses, adult children or siblings, or next-of-kin, as well as others. Now, family members or other interested persons who are questioning the conduct of an attorney-in-fact have recourse in the form of the ability to petition the appropriate court and ask for an accounting. The court will then intervene to review the conduct of the attorney-in-fact and ensure that the conduct has properly served the interests of the principal.

Trusts. On occasion, we also see trustees who have their own ideas of what is best or appropriate for a beneficiary, whether that be a person who created the trust (i.e., settlor), or a third party beneficiary. There are many types of trusts, but this problem most often arises in the case of irrevocable trusts as opposed to revocable trusts. With revocable trusts, the settlor retains the right to revoke the trust or amend the trust which, provided they are not incapacitated, gives the settlor the ability to give the boot to a trustee who is not conducting the trust in the way the settlor originally envisioned or as the trust is written. Irrevocable trusts typically do not afford the settlor those same powers of revocation or amendment. In these irrevocable trusts, there may be discretionary decisions which the trustee must exercise for the benefit of the settlor or others in terms of distribution of income or principal for the support or maintenance of those beneficiaries. We have seen situations where moms or dads set up trusts where they are supposed to receive discretionary distributions of income or principal during their lifetime for living and support, and one or more sons or daughters are appointed to act as trustees and exercise those discretionary decisions. Sometimes, the sons or daughters, who are also beneficiaries of the trust assets once mom or dad have passed, start putting their interests as future beneficiaries ahead of the needs of the parents. Sometimes it is difficult to remove those trustees based on the language of the trust.

With respect to the conduct of the trustee, there has, for a long time, been the option for an interested person to petition a court to review the conduct of a trustee and require an accounting of their activities. This was recently reenacted in the new Minnesota Trust statute, Chapter 501C. In addition to require an accounting, the court has other oversight powers or possible remedies it can use as set forth in the statute. However, this may not include the court's ability to remove a trustee where discretionary powers are involved.

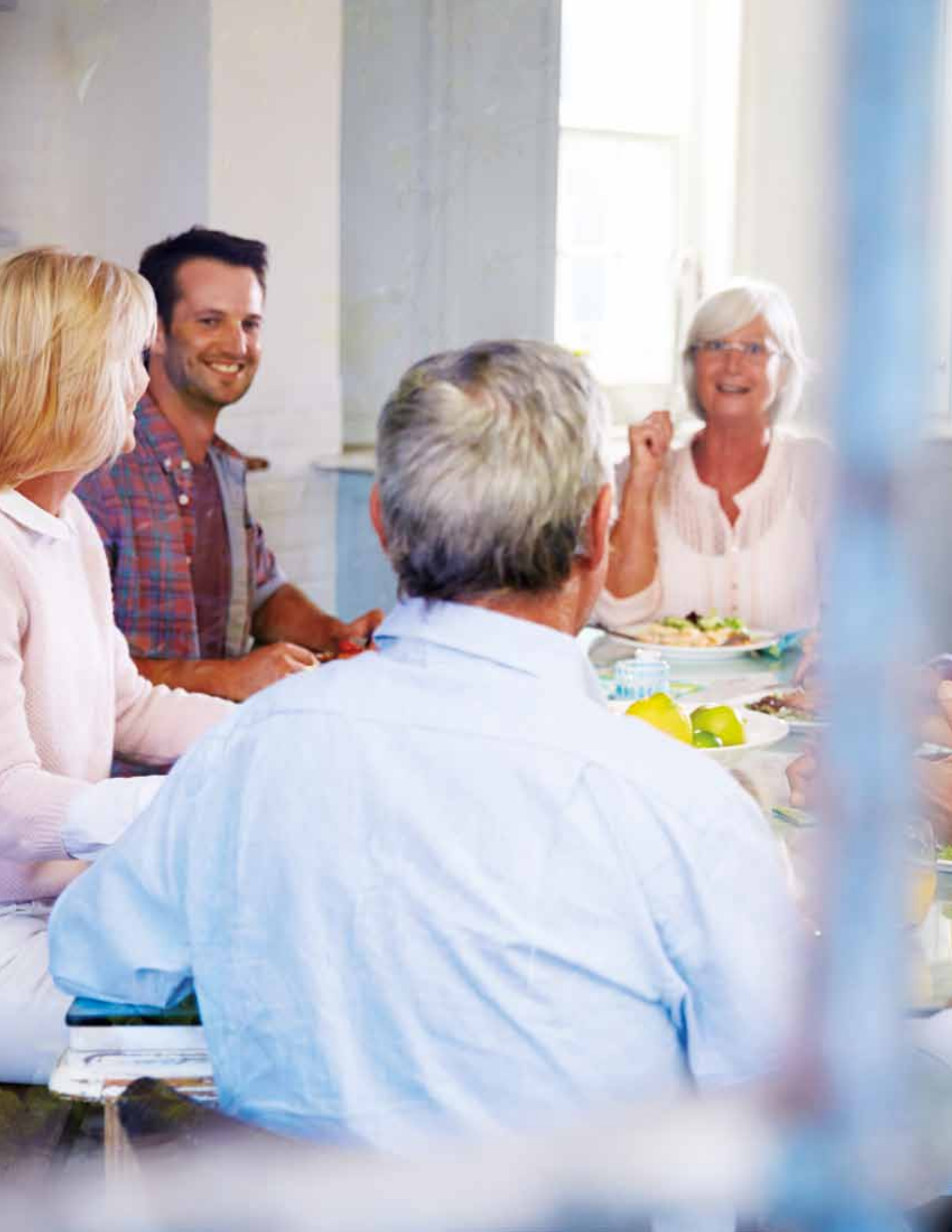
As everyone knows, court actions can oftentimes be slow and expensive, with the trust assets being subject to pay the court costs and attorney's fees of both the defending trustee and the petitioning interested person. One option to avoid this, of course, is to pay closer attention to the Trustee removal provisions in the trust document at the time it is established. That can avoid the need for court proceedings. In addition, in 2015 Minnesota Chapter 501C added the new statutory concept of a "trust protector." The concept of a trust protector has been used in Minnesota for quite some time by some estate planning attorneys and has been recognized or used in other states; however, this is the first time, from a statutory standpoint, that a trust protector has been recognized in Minnesota. A trust protector is somebody other than the trustee whose duty it is to protect the trust or, in other words, make sure the trust functions in the way originally intended by the settlor. Under the statute, there are a number of powers which the trust protector may exercise if they are provided for in the trust document. Those include the removal and/or appointment of a trustee, among other things. The exercise of or failure to exercise the powers is in the sole and absolute discretion of the trust protector and is binding on all persons, including the trustee. This would be another way of avoiding long and protracted court proceedings to try to remove a rogue trustee. Of course, the trick is to make sure that the trust protector can be trusted to exercise his or her powers consistent with the original intent and wishes of the settlor. Having a rogue trust protector could make matters worse, not better. For that reason, it is probably better to have a nonfamily member or institution to serve as the trust protector –

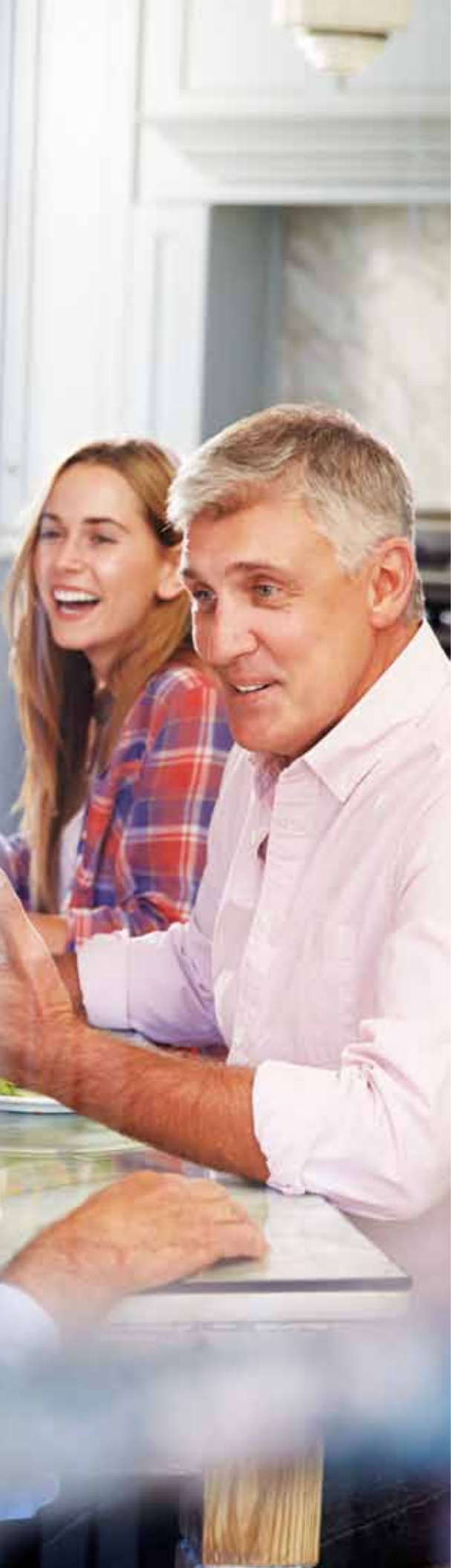
someone who is not also a beneficiary and not a member of the family, but who can be objective and not subject to other incentives or pressures when exercising the power. Trust protectors, if carefully and thoughtfully used, can provide a fairly straightforward and simple process for removing a rogue trustee, as an alternative to judicial action.

Personal Representative. A personal representative is a person nominated by a decedent in the will and appointed by a court in a probate proceeding to administer the probate estate. Such person or entity owes a fiduciary duty to the beneficiaries or heirs of the decedent. The risk of a rogue personal representative is considerably limited because of the fact that any interested party in a probate can petition the court to review a singular transaction or action of the personal representative or all actions of the personal representative. In any event, by law, the personal representative is required to file an inventory with the court and a final account reflecting the actions taken and financial aspects of the estate. Because a probate already involves the court at a certain level, it is fairly easy, by way of a petition, to ratchet up the involvement and supervisory role of the court if requested by any of the interested parties.

Conservator. Like the personal representative, a conservator may be nominated by the person for whom the conservator is appointed (i.e., ward), or may be nominated by other interested parties. In all events, the conservator is appointed by the court to manage and administer the financial affairs of a ward during the ward's lifetime. As in the case of the personal representative, the court has considerable leeway in supervising the conduct of a conservator and at least annually, each conservator must file an accounting with the court showing activities and conduct during the year. Accordingly, as in the case of a personal representative, the risk of a conservator going rogue is quite small and limited.

Although rogue fiduciaries often, in the past, have led to lengthy, protracted and expensive litigation in the courts, or leave interested parties with no remedy at all, it is hoped that, with the additional remedies set forth in the recent changes to the power of attorney statute and the new trust statute, the instances of those disputes can be significantly curtailed, and the resources available for keeping fiduciaries in check considerably simplified and streamlined.





THE IMPORTANCE OF FAMILY MEETINGS

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When estate plans are developed, a question often asked is: Should we discuss our plan with the rest of the family?

The answer is almost always yes. Then the question becomes how and when? Family relationships are filled with a variety of dynamics. There can be differing attitudes toward assets or business interests, variant skills and attitudes toward spending money, concerns about "fairness," "playing favorites," and family roles. As people complete their estate plans they make choices about roles family members may be asked to play in the plan, such as personal representative/executor, trustee, health care agent, and attorney-in-fact. Decisions are also made regarding the division of assets which sometimes entails something other than a strictly equal treatment of heirs. Where there are sensitive dynamics in the family or where there are provisions in the plan that could be interpreted as preferential or even "unfair," some form of communication regarding the intent of the plan and the reasons behind the choices is almost always helpful. The single biggest contributor to Will challenges or other post-death litigation is surprise, not disappointment. Heirs who are surprised by a decision that does not "go their way" are much more likely to want to know why and will have no ability to go directly to the decision maker. This can lead to speculation about the reasons for the decision that can include questions about undue influence, elder fraud/abuse, and other potential legal challenges to the carefully prepared documents.

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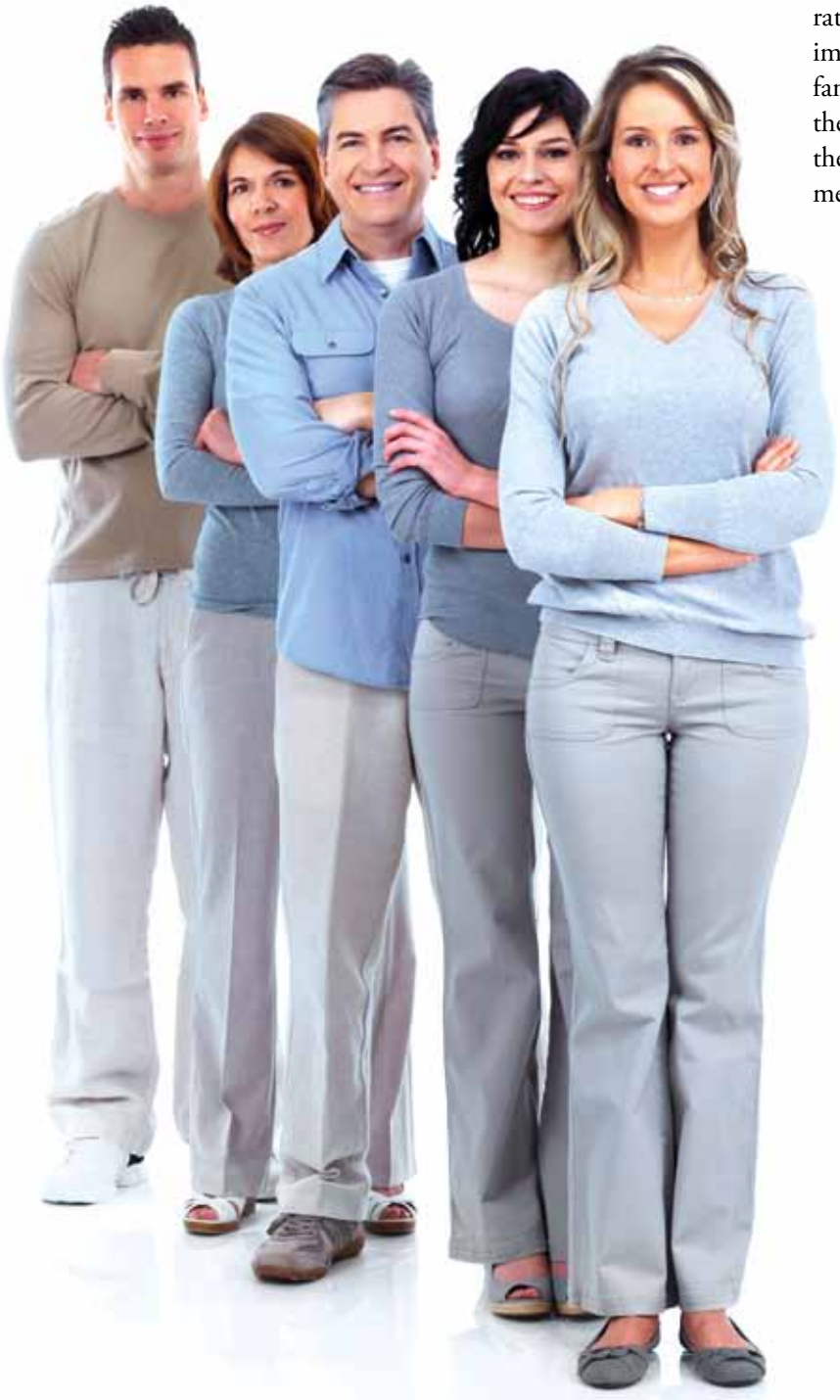

Some form of communication regarding the intent and rationale for the decisions reflected in the plan is an important vehicle for avoiding later disputes. Often, a family meeting, led by the estate planning attorney, is the best choice for communicating the reasons behind the decisions reflected in the plan. A good family meeting would address the following points:

- A summary of the basic outline of the estate plan and the relevant, applicable documents. NOTE: It is not necessary that every family member be given a complete set of the plan documents, though in certain instances that may be appropriate. The overall goal is to give a solid, but general understanding of how assets will be distributed at death and what form those assets will take.

- A summary of who will be performing what roles in handling the estate, including identifying the personal representative and trustee and their respective successors. It may be advisable to provide some explanation as to why certain individuals were chosen. There may be any number of individuals that have the necessary skills and diligence to perform the roles. Selecting among the appropriately skilled individuals is sometimes a matter as simple as birth order. It should be made clear that these roles do not provide any financial advantage or ability to change the testator's desires as reflected in the Will. Rather, while there might be some "honor" in it, being nominated for the role of personal representative and trustee is actually more work than benefit to the person named.

- The family should be provided with information about the tax impacts of the estate plan. For simple estates, it is often comforting to know that assets inherited do not result in income tax and that there would be no estate tax due. Where estate taxes are potentially due, or where there are complex income tax provisions, these should be explained so that individual family members at least understand the broad parameters of the tax impacts.
- The meeting should also provide a summary of the health care directives and who among the family has been appointed as health care agent. Where there have been instructions regarding end of life care, burial wishes, organ donation, and other such matters, all of the family should be informed so that there is minimal chance of confusion or dispute at end of life.
- Powers of attorney should also be explained, both in general concept as to the form and purpose of the document as well as the details regarding the attorneys-in-fact and their role in the couple's financial transactions. Usually this involves a discussion of how the couple's financial affairs are currently being managed and the role of the attorney-in-fact under the power of attorney to assist with that functioning at an appropriate time.

A short, well-structured family meeting can be effective to both convey knowledge and avoid later disputes among family members regarding an estate plan. As the complexity of an estate plan increases, the importance of a family meeting also increases. However, even in the most common situations, a meeting can be a helpful tool.

NEW MINNESOTA TRUST CODE

To keep pace with a much expanded scope of trust law, Minnesota has adopted a new trust code, Chapter 501C of MN statutes, effective January 1, 2016. Currently 30 states have adopted the uniform trust code – some, such as Minnesota, with modifications. The new law also updates the law on powers of appointments in a new Chapter 502. The flexibility built in to the new provisions will allow attorneys to better meet the needs of their clients.

Gislason & Hunter Estate Planning Services

Estate Planning is important to ensure the orderly transfer of family assets, as well as to protect those assets from unnecessary taxation. The Gislason & Hunter Estate Planning Practice Group offers a variety of services to assist you in creating the best plan for you, your family, your business or your farm.

Some of the many services our attorneys offer include the following:

- 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
- Farm estate and succession planning
- 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

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