Spring 2017

Estate Planning newsletter

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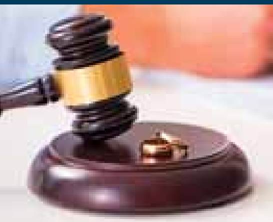
INSIDE THIS ISSUE

pg. 1
What Are the Differences Between Probate and Non-probate Assets?

pg. 4
Attorneys-In-Fact: With Great Power Comes Great Responsibility



pg. 8
Divorced? Make Sure to Change Your Life Insurance Beneficiary Designation

pg. 11
Estate and Succession Planning Issues Impacting Small Business Seminar

GISLASON & HUNTER LLP
ATTORNEYS AT LAW
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WHAT ARE THE DIFFERENCES BETWEEN PROBATE AND NON-PROBATE ASSETS?

While planning your estate it is important to understand the difference between non-probate and probate assets. Even if you have a Will, it will not control the distribution of those assets which are non-probate property. Instead, the nature of your ownership interest in a non-probate asset, or beneficiary designations, may be controlling. Your goal should be to make informed decisions as to your wishes and how your estate assets, whether probate or non-probate, will be distributed.

What is Probate: Probate refers to the process by which a court oversees the administration of your estate and the distribution of your property after you die. It includes the filing of your Will, appointment of your Personal Representative, paying legally enforceable

continued on pg 2

WHAT ARE THE DIFFERENCES BETWEEN PROBATE AND NON-PROBATE ASSETS?

continued from pg 1

debts and expenses (including taxes if any are due), distributing property to your heirs and filing a final account. The time and expense of probate is generally not as significant as people are often led to believe. However, when circumstances call for it, there are some convenient and inexpensive means, as well as some more and expensive ones, to arrange your estate such that probate is unnecessary. Whether, how and to what extent your estate should be arranged as to avoid probate will be a point of discussion with your estate planner.

Probate Assets: These are interests owned solely by you, and probated either through the directives of your Will, or if there is no Will, through statutory distribution directives. Examples of probate assets include:

- Real estate titled solely in your name or held by you as a tenant in common with another owner.
- Personal property such your household belongings, collections, jewelry and vehicles.
- Bank accounts held solely in your name or as a tenant in common.
- Life insurance, brokerage accounts and retirement plans that do not designate a beneficiary, or that identify you or your estate as the beneficiary.
- Interests in a partnership, corporation or limited liability company held in your name.

Non-probate Assets: These are not governed by your Will and therefore may not get distributed through the probate process after you die and instead pass directly to designated persons. Whether an asset is non-probate depends upon its nature and ownership status. Examples of non-probate assets that will not be controlled by your Will and will avoid probate after you die include:

- Accounts owned solely in your name, with a payable on death (POD) or transfer on death (TOD) designation.
- Real estate held under an effective transfer on death deed (TODD).
- Assets, including real estate, in which you retain a life estate and the remainder passes to someone other than yourself.
- Assets you own in joint tenancy with your spouse or others (such as a child or sibling), with rights of survivorship. The survivor(s) will own the property after you die without probate proceedings.
- Assets owned by your revocable living trust at your death. Note that even if you have such a trust, any assets that aren't actually owned by your trust at the time of your death but remain in your individual name, will not avoid probate after you die.
- Assets you own through contract rights which are payable to a designated beneficiary after your death, such as life insurance policies, IRAs, 401(k)s and annuities.

Advantages and Cautions: Owning non-probate property is a relatively easy and inexpensive way to avoid probate. Non-probate property will generally be available to your heirs within a short period of time after your death once your heirs receive a death certificate. However, there can sometimes be unintended difficulties. Some examples are:

- While transferring title to real estate through a TODD will be accomplished easily and quickly, ownership by multiple heirs and their spouses will make a subsequent sale of the property more complicated than if the personal representative of your estate were able to do it alone. Joint or multiple owners have to all agree to a sale.
- Property may end up being owned by beneficiaries in a fashion contrary to your intentions, such as if you own a bank account jointly with one of your children for the purpose of paying your bills after you die. That child is then the sole owner of the account, regardless of your other intentions, and is under no legal obligation to pay your expenses or to divide the balance of the account with your other children.

Thus, while it is a very useful and relatively inexpensive tool and solution to avoid probate, creating non-probate property should be used only after careful consideration and an understanding as to exactly who will own it after you die and the legal consequences of adding owners to accounts or real estate deeds.

By Andrew A. Willaert Jr.
507-387-1115
awillaert@gislason.com

By Abigail A. Pettit
763-225-6000
apettit@gislason.com

ATTORNEYS-IN-FACT: WITH GREAT POWER COMES GREAT RESPONSIBILITY

The Power of Attorney is a routine tool in the estate planning world. But what does it mean to serve as someone's "attorney-in-fact", and what considerations should you make when selecting your own attorney-in-fact?

First, it's important to understand the basics. An attorney-in-fact is the person appointed to act on your behalf pursuant to a validly executed power of attorney. You can either designate someone to act in a limited capacity, with regard to certain kinds of assets or transactions, or you can grant a more wide-ranging authority, essentially granting a blanket power over your personal and real property (including financial accounts). However you decide to do it, your attorney-in-fact will have the power and authority to enter into certain transactions, including, if you wish, real estate transactions, on your behalf and without advance notice or consent. In Minnesota, a power of attorney cannot be used to designate health care decision making – you'll need a health care directive in order to do that.

continued on pg 6

ATTORNEYS-IN-FACT: WITH GREAT POWER COMES GREAT RESPONSIBILITY

continued from pg 5

In many cases, a power of attorney truly becomes useful when a principal, or person granting the power, is incapacitated or incompetent. Some people may choose to use a power of attorney which is effective immediately and remains in effect if the principal becomes incapacitated or incompetent a "durable power of attorney." Others choose to use a power of attorney which only becomes effective upon incapacitation or incompetency, what's referred to as a "springing power of attorney." In either case, the person selected as attorney-in-fact will ultimately be responsible for making significant decisions for a principal who cannot participate meaningfully. For that reason, the law imposes strict duties attorneys-in-fact, and it is important to keep those duties in mind when choosing an attorney-in-fact, or when agreeing to act as someone's attorney-in-fact.

An attorney-in-fact is a fiduciary, which means that they have certain legal duties and obligations toward the person they act for, the principal. Most importantly, an attorney-in-fact must act with the best interests of the principal in mind, in good faith, and in the same way as an "ordinarily prudent person of discretion and intelligence" would manage her own affairs. An attorney-in-fact must use care, competence, and diligence in exercising her duties. These duties are referred to broadly as "fiduciary duties", and they are central to the role that an attorney-in-fact plays for their principal.

What this really means is that an attorney-in-fact has the legal duty to act carefully, thoughtfully, and in the best interests of the principal. If an attorney-in-fact fails in their fiduciary duties, they are liable to the principal for any damage that occurs as a result. If an attorney-in-fact acts in "bad faith", or with intent to deceive, commit fraud, or intentionally violate their duties, they may be liable to any person who is harmed as a result of their action, including the principal.

An attorney-in-fact must also keep complete records of transactions entered into on behalf of the principal, and when asked to, they must render accountings of all the actions they have taken. Periodic accountings may be required as part of the power of attorney, or may just be requested. If an attorney-in-fact reimburses herself for expenditures made on behalf of the principal, that reimbursement must be accounted for as well.

Selecting an attorney-in-fact should be done carefully, and you should consider a person's ability to not only manage your financial decisions and assets, but their ability to keep good records and act carefully (and competently) in your best interests. Consider that even close family members or friends who you love dearly may not be the ones you want keeping track of your bank account after you are no longer able to do so. In the case of a Minnesota short form attorney power of attorney, you should also be mindful that the powers and authority granted becomes immediately effective, whether you are incapacitated or not. An attorney-in-fact should be someone you have trust and confidence in, as well as someone who is fully equipped to responsibly carry out the fiduciary duties and record keeping obligations required by law.

For more information regarding how a power of attorney may be useful in your estate plan, or if you have questions about serving as an attorney-in-fact, the estate planning attorneys at Gislason & Hunter are ready to assist you. ■

By Reed H. Glawe
507-354-3111
rglawe@gislason.com

DIVORCED? MAKE SURE TO CHANGE YOUR LIFE INSURANCE BENEFICIARY DESIGNATION

In the very recent case (April 3, 2017) of *Metropolitan Life Insurance Co. v. Kaye Melin, et al.* (*"Metropolitan"*), the United States 8th Circuit Court of Appeals decided a Minnesota case involving life insurance, a previously divorced couple, and a Minnesota law which states that in the case of a divorce, the beneficiary designation of a spouse on a life insurance policy is revoked. The case involves a man who purchased life insurance in 1997 and then married later that year. The next year, he named his new spouse as the primary beneficiary and his two adult children as contingent beneficiaries of the policy. Later, in 2007, the couple divorced, but the beneficiaries were never changed on the policy. The man then died in 2011, and the issue was, who was entitled to the insurance proceeds: the ex-spouse, because she was named as the primary beneficiary on the policy, or the two adult children, because of the divorce?

continued on pg 10

DIVORCED? MAKE SURE TO CHANGE YOUR LIFE INSURANCE BENEFICIARY DESIGNATION

continued from pg 9

Minnesota has a statute – Minn. Stat. § 524.2-804 – which in 2002 was amended to address this situation. There are several exceptions in the statute, but its basic tenet is that the dissolution or annulment of a marriage revokes a beneficiary designation (among other things) made by the policyholder in favor of the individual's former spouse. The effect of the statutory revocation is to treat the insurance policy as though the former spouse died immediately before the dissolution or annulment. In the facts of the *Metropolitan* case, the effect of the statute would be to treat Melin, the ex-spouse, as though she died before the 2007 divorce, and under the insurance policy, since the primary beneficiary is treated as having died, the contingent beneficiaries – the two adult kids – become the recipients of the insurance proceeds. The Court of Appeals ruled that such result was unconstitutional under the facts of that case.

Article One, Section 10, Clause 1 of the United States Constitution contains what is commonly referred to as the "Contracts Clause." That clause prohibits any state law from impairing the obligation of contracts. In short, it prohibits any state from impairing an existing contractual relationship which does not serve a legitimate public purpose or is not based upon reasonable conditions and of a character appropriate to the public purpose. In *Metropolitan*, the life insurance policy in question was purchased in 1997. The Minnesota law in effect at that time did not revoke the spousal beneficiary designation in a life insurance policy upon divorce; that change to the statute was not made until 2002. The rationale of the Court, which it has applied in similar cases in the past, is that the policyholder's expectation, at the time the insurance policy is taken out, relies upon and is based upon the state and federal law governing insurance contracts as it exists when the insurance policy – the contract – is made. In other words, the U.S. Constitution says that a state cannot enact a law disrupting a prior existing lawful contract, unless the state has a strong public policy reason for doing so.

In the *Metropolitan* case, the insurance contract was purchased in 1997 at a time when Minnesota state law did not automatically revoke a spousal beneficiary designation in an insurance policy upon divorce. That change was made in 2002. Accordingly, the Circuit Court held that the 2002 Amendment to the Minnesota statutes could not be applied retroactively to the 1997 insurance policy, because it violates the Contracts Clause of the United States Constitution. The Court of Appeals in *Metropolitan* reversed and remanded the case, but based on its holding, it would appear that the ex-spouse will be entitled to the insurance proceeds.

Metropolitan should have limited effects, in that it should only apply to life insurance policies that were taken out prior to the effective date of the 2002 amendment to the Minnesota statute. As to those policies, if the policyholder named the former spouse as the primary beneficiary, unless that policyholder changes the designation himself or herself, that ex-spouse will still be entitled to receive the insurance proceeds upon death. The state statute will not apply to automatically revoke that designation; the policyholder must do it. For policies purchased after the 2002 amendment, *Metropolitan* should not apply, because the law in effect at the time the insurance is purchased, and the expectations of the policyholder at that time, would be that, in the event of a divorce, the Minnesota statute will automatically revoke the designation of the ex-spouse as a beneficiary on the insurance policy. Of course, the Minnesota statute is intended as a safety net; the prudent course of action for every policyholder following a divorce, regardless of when the policy was purchased, should be to proactively change the beneficiary designations on every life insurance policy, as well as other beneficiary designation instruments.

Gislason & Hunter LLP & CliftonLarsonAllen
Invite You to Be Our Guest

Estate and Succession Planning Issues Impacting Small Business

Thursday, May 25, 2017

Oak Ridge Conference Center
1 Oakridge Drive
Chaska, MN 55318

11:30 a.m. – Registration
Noon – Complimentary Buffet Lunch
12:30 – 3:30 – Seminar

Name ______________________________

Address ______________________________

City ______________________________

State ______________ Zip ______________

Phone ______________________________

Email ______________________________

RSVP: jdonner@gislason.com

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Seminar to Feature:

Andy Biebl – CLA Tax Principal Presenting: Tax Update for Small Business
- New legislation allowing tax free employee medical reimbursements
- 50% bonus depreciation opportunity on building improvements
- Jobs tax credit opportunities
- Tips on dealing with the IRS

Gislason & Hunter Legal Team – Wade Wacholz, Kaitlin Pals, Abby Pettit
- Buy-Sell Agreements – why have one and the critical terms for integrating with estate plans
- Basics of MN Estate Tax and how it relates to the Federal Estate and Gift Tax System
- Succession Planning - tools and techniques for business owners

Nick Houle – CLA Tax Principal
Top Issues for 2017

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

Gislason & Hunter Wills, Trusts, Estate Planning & Probate Practice Group:

Daniel A. Beckman	dbeckman@gislason.com
Reed H. Glawe	rglawe@gislason.com
David Hoelmer	dhoelmer@gislason.com
Kaitlin M. Pals	kpals@gislason.com
Abby Pettit	apettit@gislason.com
Andrew M. Tatge	atatge@gislason.com
Wade R. Wacholz	wwacholz@gislason.com
Andrew A. Willaert	awillaert@gislason.com
C. Thomas Wilson	twilson@gislason.com
Sara N. Wilson	swilson@gislason.com

This publication is not intended to be responsive to any individual situation or concerns as the contents of this newsletter is intended for general informational purposes only. Readers are urged not to act upon the information contained in this publication without first consulting competent legal advice regarding implications of a particular factual situation. Questions and additional information can be submitted to your Gislason & Hunter Attorney.

LOCATIONS

Minneapolis Office
Golden Hills Office Center
701 Xenia Avenue S, Suite 500
Minneapolis, MN 55416
763-225-6000

Des Moines Office
Bank of America Building
317 Sixth Avenue, Suite 1400
Des Moines, IA 50309
515-244-6199

Mankato Office
Landkamer Building
124 E Walnut Street, Suite 200
Mankato, MN 56001
507-387-1115

New Ulm Office
2700 South Broadway
New Ulm, MN 56073
507-354-3111

www.gislason.com

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ATTORNEYS AT LAW
www.gislason.com