

MSBA Probate & Trust Law Section Newsletter

A Publication of the Minnesota State Bar Association Probate & Trust Law Section

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If you have any questions about the publication or would like to submit an article for a future issue, please contact Catherine Clifford or Chad Bigalke.

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Message from the Chair

Though it does not feel like it yet, the vernal equinox tells us that it is spring in Minnesota. That means that we have been busily preparing for, and are now looking forward to seeing all of you at, the great Trust and Estate get together in June - the Probate and Trust Section Conference. The Education Committee and Minnesota CLE have prepared two days of wonderful seminars for all of you attending the Conference. We appreciate all of the input that we have received from our Section members, and we hope that you will continue to let us know if there are things that the Council should be working on to improve your practices and the services that you provide to your clients.

Wills for Heroes

Congratulations and great job volunteers!! After only four years, the Wills for Heroes and its volunteers have provided over 4,000 first responders and their spouses with Wills, Health Care Directives, and Powers of Attorney.

Now booked through 2013, MN Wills for Heroes will continue helping those who, everyday, make it their profession to keep Minnesota and it's citizens safe. If you are interested in becoming a volunteer attorney or volunteer data entry personnel, please contact Susan Link at susan.link@maslon.com OR Andrea Bischoff at andrea.bischoff@maslon.com OR you can call the WFH number at 612-672-3493.

Gene Daly Award

The Gene Daly Award is periodically awarded to Section members who have made a strong and positive impact on the estate

planning practice in Minnesota.

If you would like to nominate someone for the award, please contact Andrea Breckner at (612) 455-1002 or abreckner@olsonbreckner.com.

Greater Minnesota Study Group

The Greater Minnesota Study Group meets by phone once each month to discuss estate planning, trust and estate topics of interest to the members. The members are lawyers from outstate communities. Usually five to eight members of the Probate and Trust Law Section participate in the calls. Bradley Hanson, of the Quinlivan firm in St. Cloud, sets up the monthly call and leads the discussion. This study group provides both the opportunity for mentoring as well as the challenge of analyzing complex legal issues.

JoEllen Doebbert

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36th Annual Minnesota Probate & Trust Law Section Conference

Mark your calendars! The 2011/36th Annual MN Probate and Trust Law Section Conference will be held on June 6 & 7 at the St. Paul River Center. Stay tuned for more information.

Probate & Trust Law Section Council Meeting Dates

The Council is scheduled to meet on the following dates:

April 21, 2011

May 19, 2011

All meetings begin at 3:30 and are held at the Minnesota State Bar Association Offices President's Room at 600 Nicollet Mall in Minneapolis.

Tax Update

The Tax Relief, Unemployment Insurance Re-Authorization and Job Creation Act of 2010 or Kick the Can Down the Road 2 Years Act

The President signed the 2010 Tax Relief Act on December 17th, which basically extended most of the tax provisions for another two years that were set to expire on December 31, 2010. Sections of the Act that are of particular interest to the Probate and Trust Section are as follows:

The Act extends the charitable rollover provision for those individuals who are over 70 ½ to request their retirement plan administrator to distribute up to \$100,000 of their account directly to one or more charities of the taxpayer's choice. Taxpayer then will not have to report that income on their personal tax return nor do they get the tax deduction, which is generally a huge benefit to the taxpayer. This provision previously expired December 31, 2009 and the new legislation renews this provision for 2010 and 2011 (an exception to the general sunset of December 31, 2012 for most of the other provisions of this Act). These distributions may satisfy the required minimum distribution requirements for the participants. Such distributions during January 2011 can qualify as a 2010 distribution, which may be a final "out" for those elderly clients who forgot to take their 2010 distributions by the end of the year.

The Federal Estate Tax was retroactively re-imposed back to January 1, 2010, but with a \$5 Million Dollar equivalent applicable credit, a 35% tax rate and a step-up in basis. For deaths during 2010, an election may be made to be use the old law of no federal estate tax but with carryover basis. Once made, said election is irrevocable. The IRS has yet to issue appropriate forms for the election and for making the required report of the

carryover basis. The federal tax return is due nine months from the later of December 17, 2010 or the date of death.

2010 taxable gifts are still subject to a \$1 Million Dollar lifetime exemption and a top tax rate of 35%. For 2011 and 2012, the gift tax is reunited with the estate tax for a lifetime total exemption of \$5 Million Dollars. Additionally, the new act repeals Section 2511(c) that made practically all gifts into a trust taxable during 2010.

The 2010 Tax Act introduces portability of the applicable credit between spouses. Any credit not used by the first to die spouse can be carried over and used upon the death of the surviving spouse, but only if a federal estate tax return is done on the first death. Some commentators suggest that this means that there will be no closure on re-examination of the valuations reported on the first 706 until closure of the surviving spouse's estate. A surviving spouse who later remarries loses any carryover from the first spouse upon the death of the second spouse. This provision is for 2011 and 2012, which, if not extended, would require both spouses to die within either of those two years in order to be effective. (Query: does this mandate a CYA letter for your file in all estates regardless of size where there is a surviving spouse?)

The generation skipping tax is also revived with a \$5 Million Dollar lifetime exemption for 2010 through 2012. The tax rate for any GST for transfers made in 2010 is zero (0%). For the other two years it is 35%. The GST exemption is not portable between spouses.

The 2010 Tax Act also extends and increases the AMT patch for 2010 and 2011 tax years. Without further action, the AMT exemption will fall back to what it was in 2001 and impose that tax on most moderate and high income taxpayers in 2012.

Advance Care Giving

Kristine E. Mullmann, JD

Estate Crafters

Chair, National Healthcare Decisions Day – MN

February 28, 2011

Over the past 60 years life expectancy of the average American has surged from 68 to 78 years. However, as life expectancy has increased, so too have the multiple complications associated with chronic illnesses in the last years of life. Due to this phenomenon it is vitally important for advance care planning to become part of every client's experience.

Advance care planning is about having conversations between clients and their health care agents and loved ones about their desires and values related to health care at the end of life. The result is the completion of a health care directive.

A health care directive is a way to express and document our health care preferences including the type of treatment we do or do not want in the event we cannot speak for ourselves. It combines two separate documents: a durable power of attorney for health care which allows individuals to name an agent to act on their behalf when unable to speak for themselves and a living will which provides specific health care preferences and instructions. To be considered valid, a health care directive must be: in writing, dated, state the client's name, executed by a client with capacity to do so, verified by a notary or two witnesses and include either health care instructions or a health care power of attorney.¹

With a better understanding of the health care directive document there will hopefully be improved communication between the drafters and the health care providers who are ultimately responsible for implementation of the health care directive.

HISTORY

Minnesota first passed a living will statute in 1989.² Although it was in place for many years, it had its limitations with regard to its form and its effectiveness only with terminally ill patients. In August 1998 Minnesota law underwent a fundamental change. It removed statutory limitations previously required by the living will statute. It no longer became effective only if the individual became terminally ill and it didn't require a specific form focused on life sustaining treatment. Previously separate documents such as the durable power of attorney for health care, the living will and the mental health directive were combined and all aspects of advance care planning could be addressed in one document. These changes created the health care directive that we continue to use today.

HEALTH CARE AGENT

Through the "power of attorney for health care" provisions, individuals may name an agent to act on their behalf when unable to make or communicate decisions.³ This is

viewed by most health care providers as the most important aspect of the health care directive because it designates a substitute decision maker with whom physicians can discuss care options and from whom they can receive authorization for care delivery. When making decisions a health care agent has a duty to act in good faith, but this obligation does not constitute a legal duty to act.⁴

A health care agent acting pursuant to a health care directive has the same right as the principal to receive, review, and obtain copies of medical records of the principal, and to consent to the disclosure of medical records of the principal.⁵ Even though the legislature gave this power to the health care agent, it is often recommended that specific language authorizing the agent to obtain medical records be used to overcome the misapplied barriers of the Health Insurance Portability and Accountability Act of 1996 (HIPAA).

HEALTH CARE PREFERENCES

The health care directive also provides an opportunity to state specific health care preferences and instructions.⁶ Unlike the previous statute, this is not applicable only when the patient is in a terminal condition. Therefore, patients are free to address their values, beliefs, preferences, and directions regarding health care now or in the future.

CAPACITY

A health care directive can be executed or revoked by anyone “with the capacity to do so”.⁷ This is left undefined, however, the principal is presumed to have the capacity to execute a health care directive and to revoke a health care directive, absent clear and convincing evidence to the contrary.⁸

A health care directive becomes effective

when a principal lacks “decision-making capacity” to make a health care decision.⁹ Decision-making capacity is defined as the ability to understand the significant benefits, risks, and alternatives to proposed health care and to make and communicate a health care decision.¹⁰ A health care directive is not effective for any decision for which the principal, in the determination of the attending physician of the principal, has decision-making capacity.

OPTIONAL PROVISIONS

Other advance planning designations can also be included in a health care directive. For example, the health care agent is automatically nominated to be the guardian of the person.¹¹ A health care directive can also include:

- A declaration regarding intrusive mental health treatment or a statement that the agent is authorized to give consent to voluntary treatment or admissions to a treatment facility;¹²
- Organ donation; and¹³
- Funeral and burial instructions.¹⁴

PRESUMPTIONS

A few presumptions were added or clarified in 1998 to make execution and implementation of the health care directive document itself easier. Absent a showing of clear and convincing evidence to the contrary, a health care directive is presumed to be properly executed and remain in effect until the principal modifies or revokes it.¹⁵ A copy of a health care directive is presumed to be a true and accurate copy of the executed original and must be given the same effect as an original.¹⁶ A health care provider acting pursuant to the direction of a health care agent is presumed to be acting in

good faith.¹⁷

Finally, the last presumption addresses the rare situation when health care decisions need to be made for pregnant women unable to express their own wishes. The presumption is that if health care to sustain a pregnant woman's life and the life of the fetus is provided the fetus could survive to the point of live birth, the health care provider *shall* presume that the patient would have wanted such health care to be provided.¹⁸

IMMUNITIES

A health care provider is not subject to criminal prosecution, civil liability, or professional disciplinary action if the health care provider relies on a health care decision made by the health care agent and the following requirements are satisfied:

- (1) the health care provider believes in good faith that the decision was made by a health care agent appointed to make the decision and has no actual knowledge that the health care directive has been revoked; and
- (2) the health care provider believes in good faith that the health care agent is acting in good faith.¹⁹

A health care provider who administers health care necessary to keep the principal alive, despite a health care decision of the health care agent to withhold or withdraw that treatment, is not subject to criminal prosecution, civil liability, or professional disciplinary action if that health care provider promptly took all reasonable steps to:

- (1) notify the health care agent of the health care provider's unwillingness to comply;
- (2) document the notification in the principal's medical record; and

- (3) permit the health care agent to arrange to transfer care of the principal to another health care provider willing to comply with the decision of the health care agent.²⁰

NATIONAL HEALTHCARE DECISIONS DAY

April 16th has officially been designated National Healthcare Decisions Day (NHDD)²¹ by Congress and on April 16th every year, hundreds of NHDD events are held around the country. The NHDD Initiative, now in its fourth year, is a collaborative effort of national, state and community organizations committed to ensuring that all adults with decision-making capacity have the information and opportunity to communicate and document their health care decisions. Attendees of Minnesota NHDD²² events will have the opportunity to learn about and complete a Minnesota Health Care Directive for free on April 16, 2011.

In 2010 approximately 3,000 people attended 41 events held around the State of Minnesota where 1,500 health care directives were signed! Publicity for NHDD was circulated to over 100,000 people in Minnesota. These events were sponsored by hospitals, hospices, law firms, senior centers, churches, community centers, insurers, and law schools. Professionals in the legal, medical and social work fields all donated their time to the initiative as volunteers. Governor Tim Pawlenty, Minneapolis Mayor R.T. Ryback, and St. Paul Mayor Christopher B. Coleman all declared April 16th, 2010 to be National Healthcare Decisions Day.

CONCLUSION

As you can see with the major attention our legislature has given to the health care

directive, along with the local and national initiatives now behind the education and distribution of the health care directive it is time to not only dedicate April 16, 2011 to advance care planning, it is time to address advance care planning every day with every client we encounter.

Please join the National Healthcare Decisions Day initiative on April 16, 2011 or work with Honoring Choices Minnesota,²³ an initiative focused on health care directives throughout the year, to have the important discussions with clients and encourage them to document their wishes in a health care directive.

Notes

¹ Minn. Stat. §145C.03

² Laws of Minnesota 1989 CHAPTER 3-S.F.No. 28

³ Minn. Stat. §145C.02

⁴ Minn. Stat. §145C.07 Subd. 3

⁵ Minn. Stat. §145C.08

⁶ Minn. Stat. §145C.02

⁷ Minn. Stat. §145C.02

⁸ Minn. Stat. §145C.10

⁹ Minn. Stat. §145C.06(2)

¹⁰ Minn. Stat. §145C.10 Subd. 1b

¹¹ Minn. Stat. §145C.07 Subd. 2

¹² Minn. Stat. §145C.05 Subd. 2(6)

¹³ Minn. Stat. §145C.05 Subd. 2(5)

¹⁴ Minn. Stat. §145C.05 Subd. 2(7)

¹⁵ Minn. Stat. §145C.10

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ Minn. Stat. §145C.11 Subd. 2(b)

²⁰ Minn. Stat. §145C.11 Subd. 2(c)

²¹ www.nhdd.org

²² www.mnhealthcaredecisions.info

²³ Please visit www.metrodoctors.com to download a health care directive form for your use.

2010 Tax Act and Planning Implications For Estate Planners

John Bedosky
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On December 17, 2010, “The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010” (“The 2010 Act”) was signed into law by President Obama. The 2010 Act changes are effective beginning January 1, 2011, for two years, until December 31, 2012. As 2012 is a presidential election year, the period leading up to expiration of the 2010 Act changes will likely be fraught with the same uncertainty that we’ve had since the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), leading up to the repeal of the federal estate and generation skipping transfer (GST) taxes in 2010 and the prospect of a “sunset” of the EGTRRA provisions beginning with the 2011 tax year.

The following summarizes some of the key provisions of The 2010 Act and their planning and tax return preparation implications.

1. Estate Tax or No Estate Tax in 2010?

For decedents dying in 2010, the estate tax applies. There is a \$5 million estate tax exemption and a 35% top rate. The estate tax exemption will be indexed for inflation after 2011 (with rounding to the nearest \$10,000). A full basis step-up applies. Estate tax returns for estates of decedents dying in 2010 will be due within 9 months after the Bill is enacted.

Important exception: executors of estates of decedents dying in 2010 can *elect out* of

the estate tax regime so that no estate tax is due. If such an election is made, the basis step-up rule will be limited to \$1.3 million for non-spousal beneficiaries and \$3 million for spousal beneficiaries. The IRS will publish rules on when and how the election is to be made.

Planning Implications:

The question is **when to retroactively apply the stepped-up basis and \$5 million exemption and 35% rate** for the 2011 estate tax retroactively, and **when to use the carryover basis and capital gains tax** that had been the only tax on estates for 2010—since for 2010 there was no “estate” tax.

If the value of the decedent’s estate is \$5 million or less (including gifts made during life in excess of annual exclusion gifts), an executor should not elect out of the application of the estate tax. No tax will be due, and a full basis step-up will be permitted.

If the value of the decedent’s estate is over \$5 million, the executor should opt out if the benefits of the additional basis step-up are outweighed by the estate tax that would otherwise be due.

2. Reunification - Gift Tax Exemption is \$5 Million

For gifts made *after* 2010 and *before* 2013, the gift tax exemption is \$5 million – the same as the estate tax exemption. Any

exemption used prior to 2010 “uses up” the \$5 million exemption available under the new law. The exemption is adjusted for inflation after 2011 (with rounding to the nearest \$10,000).

Planning Implications:

Clients who survived until 2011 (and therefore were unable to pass those assets without any transfer tax by dying in 2010) and have the financial means to do so should consider making taxable gifts (above the amount of the annual exclusion gift), especially those that would result in the payment of gift tax. Taxable gifts would be sheltered from tax to the extent of the increased gift tax exemption.

Advantages of Lifetime Gifts

Lifetime gifts have always had significant tax advantages over transfers at death, including: (1) the annual gift exclusion (\$13,000 per donee in 2010), (2) the removal of future appreciation from the donor’s taxable estate, (3) removal of gifted property from state death tax (depending upon applicable state law); and (4) the fact that lifetime gifts are taxed on a “tax exclusive” basis and are therefore subject to a lower effective tax rate (unless the donor dies within three years of making the gift subject to tax).

Code¹ §2035(b) provides that, if the donor dies within three years after making a gift, the donor’s gross estate will be increased by the amount of the gift tax paid. If the gift tax rate is the same as the estate tax rate, the effect is to put the donor in the same position as if he/she never gifted the property, except that the donees of the gifted property would not receive a step up in basis.

The 2010 Tax Act confirms that the rates in effect in the year of the decedent’s death are to be used in determining the gift tax paid on each adjusted taxable gift, the applicable

credit amount used against each such prior taxable gift and the portion of the applicable credit amount used against the total gifts made prior to each such gift.

Important Note: For clients who have paid gift tax prior to 2011, less than the full amount of the additional estate tax exemption amount of \$4 million will be available to shelter additional taxable gifts made after 2010. This is because the additional gift a client may make because of the increase in the gift tax exemption will depend on both the amount of prior lifetime taxable gifts and the gift tax bracket in which the additional gifts will be taxed.

Example 1:

Aaron is not married and has several children and grandchildren. In 2006, he has assets of over \$104 million. In 2006, he made a taxable gift of \$10 million, using his \$1 million gift tax exemption and paying gift tax of approximately \$4 million (assume 45% rate). In 2011, after learning that an additional \$4,000,000 in gift tax exemption is available, Aaron wants to make an additional taxable gift of \$4 million, and not pay gift tax. Can he do so?

No, he may not. What he can do is use an additional \$3 million of applicable exclusion.

Prior Installment Sale Transactions – Using Increased Exclusion to Supplement Seed Money Gifts

A client who restricted the size of assets involved in an installment sale transaction can revisit that transaction and use up to the remaining amount of her post 2010 gift tax exclusion to make additional seed gifts to the purchaser or implement new sale transactions. If note guarantees were used in the prior transaction, additional seed gifts to the purchasing trust could permit

renegotiation and the elimination or reduction in amount of such guarantees.

2511(c) Uncertainty Eliminated

Section 303(e) of the Bill retroactively repeals IRC §2511(c), the provision that went into effect in 2010 treating all transfers in trust as gifts unless the trust is a wholly “grantor trust” as to the donor.

3. GST Tax Exemption is Increased to \$5 Million for 2010 and Automatic Allocation Rules Apply

Under the 2010 Act, the GST tax applies to GSTs occurring in 2010 (that is, if direct skips, taxable terminations or taxable distributions occurred in 2010, they are, technically speaking, not exempt from GST tax), **but the inclusion ratio is not zero**. They are subject to GST taxes, but the *applicable rate* in determining GST taxes due is zero, so no GST taxes will be due on 2010 GSTs.

Note, however, that by using this mechanism, all other GST rules apply.

The applicable exclusion amount for estate tax purposes will be \$5 million in 2010, and the GST exemption is tied to the applicable exclusion amount for estate tax purposes. Therefore, everyone has a \$5 million GST exemption in **2010**.

This also means that 2010 gifts in trust for grandchildren (when the GST *applicable rate* is zero) will not be subject to GST tax when later distributions are made to the grandchildren (although distributions to their descendants would be subject to GST tax).

Also, note that if the executor of the estate of a decedent who died in 2010 elects back in to the no-estate-tax system (as described above), the decedent will still be considered the *transferor* for GST tax purposes (as if the estate *had* been subject to estate tax).

Because the *amount of GST tax* imposed on GSTs occurring in 2010 is zero under the 2010 Act, it does not necessarily follow that the *inclusion ratio* resulting from gifts made to trusts during 2010 is also zero. Whether GST tax is imposed on GSTs made or occurring after 2010 depends upon the *inclusion ratio* applicable to the GST or to the trust from which the GST occurs.

Therefore, there may or may not be GST tax imposed when a GST is made or occurs in a year after 2010. Each *transferor* has a \$5 million GST exemption for 2010 (and thereafter until December 31, 2012). The GST tax exemption is indexed for inflation after 2011 (with rounding to the nearest \$10,000).

The automatic allocation rules apply just as they did prior to 2010, including the ability to opt out of the application of the automatic allocation rules.

Planning and Tax Preparation Points:

Clients who made direct skip gifts either outright or in trust in 2010 will not have to pay GST tax, as the applicable rate on such direct skips is zero. With respect to whether distributions in a later year to grandchildren from a trust that constitutes a skip person depends upon the inclusion ratio of that trust. Assuming that the trust is otherwise has an inclusion ratio of zero, future distributions to grandchildren *should not* be subject to the GST tax, because the *multiple skip* rule will apply to cause the client as transferor to occupy the generation level immediately above the oldest generation occupied by current beneficiaries of the trust (that is, the client would move down as a *transferor* to the generation level of the parents of the grandchildren).

When the grandchild dies, and assets pass to

the client's great-grandchildren, that will be a transfer to a "skip person" and GST tax will be imposed at that time. This result can be mitigated if the assets of the trust are included in the grandchild's estate for estate tax purposes.

In order to achieve this result, however, the client must **elect out of the automatic allocation rules, unless an allocation of GST exemption to the 2010 transfers to the trust is necessary to protect the trust's inclusion ratio.** Otherwise, the client's GST tax exemption will be automatically allocated to the gift. Because this special situation will not apply to direct skip gifts made to trust after 2010, electing out of automatic allocation for 2010 gifts will preserve the client's GST exemption for post-2010 gifts.

Direct skip bequests at death to trusts for grandchildren should be treated the same way – even if the executor opts out of the application of the estate tax. Even though there is no estate tax imposed on the estate of a decedent who died in 2010 and for which the executor opted out of the application of estate tax, the decedent is still a GST *transferor*. Thus, under the 2010 Act, the identity of the *transferor* will not change regardless of whether an executor elects to apply the estate tax or carryover basis.

Practitioners completing gift tax returns for the 2010 year should carefully consider whether to opt out of the automatic allocation of GST exemption to such a trust.

4. Portability of Estate Tax Exemption is Allowed

If a decedent who died in 2010 leaves a surviving spouse who dies thereafter, to the extent the first spouse to die failed to use his or her estate tax exemption, the surviving spouse can use the unused portion. The surviving spouse's executor has to make an

election to accomplish this result.

Only the unused estate tax exemption of the "last" deceased spouse of the surviving spouse can be used. This rule is intended to avoid "serial marriages" to accumulate unused credits. Section 303 of the 2010 Tax Act contains the portability provisions.

In Section 302(a)(2), Code §2010(c) is amended to provide that the "applicable exclusion amount" is a tax free amount of \$5 million indexed after 2011 for inflation after 2010.

Under Section 303(a), Code §2010(c) as amended by Section 302(a)(2) is further amended to refer to the \$5 million applicable exclusion amount as the "basic exclusion amount," and the "applicable exclusion amount" is redefined to be the sum of the basic exclusion amount and, in the case of a surviving spouse, the "deceased spousal unused exclusion amount."

Nine portability points:

1. Portability is effective for post-2010 decedents. It does not apply to decedents who died before January 1, 2011. And, portability will only apply if the **first** of two spouses dies after 2010 and the surviving spouse dies **before** 2013.
2. The deceased spousal unused exclusion amount (or DSUEA) of the surviving spouse is limited to the **lesser** of:
 - A. the surviving spouse's basic exclusion amount (*i.e.*, the indexed \$5 million amount – or whatever it is when the surviving spouse dies) or
 - B. the excess of the **last** deceased spouse's **basic** exclusion amount over the sum of the last deceased spouse's taxable estate **and** adjusted taxable gifts.
3. The DSUEA available to the surviving

spouse, unlike his or her basic exclusion amount, is not indexed for inflation. So unlike assets placed in a bypass trust, future appreciation is not shielded from tax.

4. Also unlike assets in a bypass trust, assets covered by the DSUEA will be eligible for a step-up in basis at the surviving spouse's death.
5. The surviving spouse can only benefit from the unused exclusion amount of his or her **last** deceased spouse, even when the surviving spouse remarries (unless and until the subsequent spouse dies before the surviving spouse).
6. The DSUEA only includes the portion of the *basic exclusion amount* that is left unused by the last deceased spouse (and not such last deceased spouse's DSUEA from a predeceased spouse).
7. The last deceased spouse's basic exclusion amount is applied first when determining whether there's any unused tax-free amount. In other words, the surviving spouse's DSUEA from the last deceased spouse will be determined as if that last deceased spouse had no DSUEA from his or her previous spouse.
8. The executor of the last deceased spouse's estate must file a *timely* estate tax return making a DSUEA election, regardless of the size of that last deceased spouse's estate.
9. The GST Exemption is **not** portable.

Example 2:

Assume that Henry I dies in 2011, having made taxable transfers of \$3 million (adjusted taxable gifts) and having no taxable estate. An election is made on Henry I's estate tax return to permit his surviving wife, Wendy, to use Henry I's deceased spousal unused exclusion amount. As of Henry I's death, Wendy has made no taxable gifts. Thereafter, Wendy's applicable exclusion amount is \$7 million (her \$5 million basic applicable

exclusion amount plus \$2 million deceased spousal unused exclusion amount from Henry I), which she may use for lifetime gifts or for transfers at her later death. Therefore, to the extent Wendy has sufficient assets to do so, she could make a large lifetime taxable gift of \$7 million and this gift will be tax free. Add this to Henry I's lifetime adjusted taxable gifts of \$3 million and we see portability at work. A total of \$10 million is transferred free of gift and estate tax from a married couple.

Example 3:

Assume the same facts as in Example 2, except that Wendy subsequently marries Henry II. Henry II also predeceases Wendy, having made \$4 million in taxable transfers (adjusted taxable gifts) and no taxable estate. An election is made on Henry II's estate tax return to permit Wendy to use Henry II's deceased spousal unused exclusion amount. Although the combined amount of unused exclusion of Henry I and Henry II is \$3 million (\$2 million from Henry I and \$1 million from Henry II), only Henry II's \$1 million unused exclusion is available for use by Wendy, because the deceased spousal unused exclusion amount is limited to the lesser of the basic exclusion amount (\$5 million) or the unused exclusion of the *last deceased spouse* of the surviving spouse (here, Henry II's \$1 million unused exclusion). Therefore, Wendy's applicable exclusion amount is \$6 million (her \$5 million basic exclusion amount plus \$1 million deceased spousal unused exclusion amount from Henry II), which she may use for lifetime gifts or for transfers at death.

Example 4:

Assume the same facts as in Examples 2 and 3, except that Wendy predeceases Henry II. Following Henry I's death, Wendy's applicable exclusion amount is \$7 million (her \$5 million basic applicable exclusion

amount plus \$2 million deceased spousal unused exclusion amount from Henry I). Wendy made no taxable transfers and has a taxable estate of \$3 million. An election is made on Wendy's estate tax return to permit Henry II to use Wendy's deceased spousal unused exclusion amount, which is \$2 million (Wendy's \$5 million basic applicable exclusion amount less her \$3 million taxable estate). Under the provision, Henry II's applicable exclusion amount is increased by \$2 million, i.e., the amount of deceased spousal unused exclusion amount of Wendy.

Planning Implications:

For married clients who expect that one or both of them will die during period in which their estates would be subject to estate tax, traditional estate planning strategies using Wills and Revocable Trusts that create credit shelter trusts on the first death and making sure that each spouse independently owns sufficient assets to fully utilize his or her basic exclusion amount still make sense. Funding a credit shelter trust on the first spouse's death allows any increased value of the trust assets that occurs between the first death and the second death to avoid estate tax. Using the portability rule will not allow that increase between deaths to avoid estate tax. In addition, in many cases, both spouses will want to use their GST tax exemptions (\$5 million per spouse, and indexed for inflation beginning in 2012). Because the GST tax exemption is not portable, the estate of the first spouse to die can use his or her GST exemption only if a GST/credit shelter trust is created out of that spouse's assets at death.

5. The 2010 Tax Act Contains No Provisions About GRATs

In prior legislative proposals, the term of GRATs would have had a minimum 10-year term. No such provision is included in the

proposed legislation.

Planning Implications:

Therefore, short term GRATs are still viable (but again, there are no guarantees about future tax changes). The timing is still right for GRATs because interest rates are still extremely low and asset values may not fully reflect intrinsic value.

6. 2010 Tax Act Contains No Limits on Fractional Interest Discounts

Valuation discounts are used with various estate planning techniques (i.e., family limited partnerships) to reduce estate and gift tax exposure. It had been rumored that the new tax bill would include limits on the ability to discount the value of assets in estate planning transactions. The proposed bill does not include such limits.

Planning Implications:

Valuation discount planning continues to be an effective way to reduce estate and gift taxes.

When this is combined with the substantial \$5 million gift tax exemption in 2011 tremendous wealth can be shifted. Since there is only a two year time horizon assured for the \$5 million exemption this may open a new and unprecedented opportunity for the wealthy to plan.

7. Reevaluating Formula Clauses and Bequests

As with the impact of EGTRRA formula clauses, a change in 2011 to a \$5 million basic applicable exclusion makes it essential for all clients to review all formula clauses tied to estate tax figures.

Because the 2010 Tax Act extends expiring EGTRRA provisions for only two years, practitioners should consider drafting formula

clauses with explanatory provisions, caps and floors, and other safeguards to deal with the unknowns of 2013 and beyond (including carryover basis?). Of course, a viable alternative is to draft to permit disclaimers and partial QTIP elections (including use of Clayton QTIPs), to fine tune the relative values allocated to various trusts or distributees.

8. Deadlines for 2010 Return Preparation and Disclaimers

The Bill provides for additional time for executors of 2010 estates to make certain elections and actions. Hopefully, the executors whose estates might benefit from these extensions heeded the general advice advisers provided to withhold distributions pending clarification of the law.

In the case of the estate of a decedent dying after December 31, 2009, and before the date of the enactment of the 2010 Tax Act, the due date for (a) filing any return under section 6018 of the Internal Revenue Code of 1986 (including any election required to be made on such a return), (b) making any payment of estate tax, and (c) making any disclaimer described in Code § 2518(b) of an interest in property passing by reason of the death of the decedent, shall not be earlier than 9 months after the date of enactment.

In the case of any GST made after December 31, 2009, and before the date of the enactment, the due date for filing any return under Code § 2662 (including any election required to be made on such a return) shall not be earlier than 9 months after the date of enactment.

The date of enactment is December 17, 2010. Therefore, September 17, 2011 is the last day of the extended deadline for filing returns, paying tax and making qualified disclaimers.

It will important to review existing documents and state law to determine whether the extension of time to make disclaimers will be permitted. States may have to provide technical amendments to their disclaimer statutes to permit state law qualification under the extended deadline. Most (as does Minnesota) states still require valid disclaimer to be filed on or before 9 months after the date of the transfer.

A possible planning approach is to use the direct transfer method of accomplishing a disclaimer, being careful to comply with the other technical requirements imposed by Code §2518 (such as, for example, not accepting the benefits of the property interest to be disclaimed).

Notes

¹ The term “Code” is to the Internal Revenue Code of 1986 and the Regulations there under.

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