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OhnstadTwichell attorneys

Newsline

Your life. Your law firm.

Ohnstad Twichell, P.C., is a full service law firm having a general and trial practice in North Dakota, Minnesota, and federal courts and offering services in the fields of probate, real estate, estate planning, corporate, labor/employment law, family law, elder law, municipal finance and bonding, taxation, personal injury, criminal, negligence, commercial, insurance defense, water rights, oil, gas and wind law, and automobile law.

TAX CHANGES – ESTATE TAX EXEMPTION

Robert E. Rosenvold *works in the West Fargo and Page offices and devotes his practice to estate planning and probate.*

The 2010 Tax Relief Act, which unexpectedly was passed and signed into law in December 2010, perhaps created the most significant changes in estate planning since the Economic Recovery Act of 1981, which introduced the unlimited estate tax marital deduction.

The most important aspect of estate planning has always been what is commonly known as the "estate tax exemption." This is the amount of net worth which a decedent can have before the heirs must pay estate tax. The estate tax exemption has increased dramatically over the years as shown:

Year	Estate Tax Exemption
1982	$ 225,000
1983	$ 275,000
1984	$ 325,000
1985	$ 400,000
1986	$ 500,000
1987-1997	$ 600,000
1998	$ 625,000
1999	$ 650,000
2000-2001	$ 675,000
2002-2003	$1,000,000
2004-2005	$1,500,000
2006-2009	$2,000,000
2010	No tax
2011	$5,000,000
2012	$5,000,000

For most of the above years, the highest federal estate tax rate was 55%. However, the estate tax for 2007 to 2009 was a flat tax with a 45% rate and in 2011 and 2012 it is a flat tax with a 35% rate.

Many clients have contacted our office for advice as to whether or not their Wills should be changed. The intention of this article is to alert those clients of ours who should consider a review of their estate plan in light of the recent changes in the law.

It is always a difficult task to attempt to inform a relatively small number of our thousands of clients that significant changes to their Wills are extremely important. On the other hand, the number of clients who must be informed is significant enough that it would be impossible to review all of our closed files to determine which clients are directly affected.

Writing an article in our firm's newsletter which is of direct concern to a wide of variety of individuals also necessitates using generalities.

The first generality is to state that the new law almost exclusively affects married couples. In other words, single individuals are unlikely to be affected.

The estate tax exemption, as noted above, is the maximum amount of net worth which an individual can leave to anyone other than his or her surviving spouse or charitable organizations upon his or her death without an estate tax liability. Married couples have always been able to double this amount by creating trusts for the benefit of his or her surviving spouse. This trust, which is created when the individual dies, can be funded with an amount of property equal to the estate tax exemption in the year in that person's death. As an example, assume an individual having a net worth of $2,500,000 died in the year 2002 when the estate tax exemption was $1,000,000. By creating a trust for that person's surviving spouse with $1,000,000 of the $2,500,000 net worth, that trust would fully utilize that person's estate tax exemption when the individual died in 2002. The remaining $1,500,000 would be devised to the surviving spouse outright. Assuming the surviving spouse had no other assets, and if the surviving spouse died in the year 2005, there would be no estate tax consequence inasmuch as the surviving spouse's estate of $1,5000,000 would equal the estate tax exemption in the year 2005.

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A legal newsletter from Ohnstad Twichell, P.C., with offices in West Fargo, Hillsboro, Casselton, and Page, North Dakota, and Barnesville, Minnesota.

Explanation of Wills which create trusts for the benefit of the surviving spouse.

Wills which create trusts for the benefit of the surviving spouse drafted by Ohnstad Twichell attorneys typically were drafted in one of the three following ways:

1. Wills which devise everything to the surviving spouse, but allow the surviving spouse to disclaim any portion devised to him or her and that which is disclaimed is placed into a trust, known as a Disclaimer Trust, for the primary benefit of the surviving spouse. The majority of our higher net worth clients have this type of Will. These clients do not need their estate plan reviewed.

2. Wills which devise specific assets to a trust for the benefit of the surviving spouse with the balance of the estate being devised directly to the surviving spouse. Often times, these specific assets would include farm real estate. Wills such as these probably should be changed depending upon whether or not the married couple believes they fit with some of the factors as set forth below.

3. Wills which contain marital deduction formula clauses. It is recommended that high net worth married clients of Ohnstad Twichell review their Wills. A marital deduction formula clause, if contained in your Will, will have rather complicated language (as required by law), which will make reference to various sections of the Internal Revenue Code and will contain language such as "the largest amount that can pass free of federal and state estate tax."

   The effect of the above language is to provide that, upon the death of the first spouse, the trust for the benefit of the surviving spouse will contain the value of the decedent's assets up to the amount of the estate tax exemption. The problem with this type of Will becomes very apparent. More specifically, such language could virtually place all of the decedent's assets into a trust for the benefit of the surviving spouse and leave the surviving spouse with little assets, if any, to control in his or her own name. For example, although this would be unusual, assume the husband has assets valued at $4,500,000 and the wife has assets valued at $200,000. If the husband dies first, his entire $4,500,000 is placed into a trust for the surviving spouse, and the surviving spouse is left with only $200,000 of her own assets. This would certainly restrict the surviving spouse's enjoyment. Also, when the surviving spouse dies, she will have her own $5,000,000 exemption but will only have an estate valued at $200,000. In other words, because of the dramatic increase in the estate tax exemption, marital deduction formula clauses, with the exception of extremely high net worth clients, should not be used. These clauses simply place too much property into a restrictive trust for the surviving spouse.

   It should also be pointed out that some of our clients have not used Wills for the above provisions but, rather, the above provisions are contained in their Revocable Living Trust. Those clients should look for the above provisions in their Revocable Living Trust and not in their Will.

   Minnesota residents who, in particular, have Wills (or Revocable Living Trusts) which contain language contained in paragraph 3 above almost certainly require changes. This is because most often the marital deduction formula clause is drafted to fund the surviving spouse's trust with property equal to the federal estate tax exemption and not the Minnesota estate tax exemption. (North Dakota has no estate tax.) The Minnesota estate tax exemption is only $1,000,000. Accordingly, if a Minnesota resident dies with a surviving spouse with a marital deduction formula clause, the trust for the surviving spouse could have up to $5,000,000 in assets. The federal estate tax will be avoided on the first death, but Minnesota estate tax will not. This is because up to $4,000,000 in excess of the Minnesota estate tax exemption is being placed into the trust for the surviving spouse. This will create $280,400 in Minnesota estate taxes payable when the first spouse dies.

The discussion as to creating a trust for the benefit of the surviving spouse up to this point has concerned only the estate tax implications of such a trust. Clients must keep in mind there are other reasons for creating a trust for the benefit of the surviving spouse other than for estate tax purposes, which would not necessitate a change in their estate plan. This includes the following:

1. Many clients have children from a prior marriage to whom they want to give a portion of their estate. These clients, in order to provide for their present spouse while, at the same time, making certain the client's children from a prior marriage will inherit, will create a trust for the benefit of the surviving spouse. This trust typically gives the income to the surviving

spouse until his or her death and, upon his or her death, the trust assets will be distributed to the client's children from a prior marriage.

2. Some clients have a spouse who simply either cannot manage assets or do not want to manage assets. These spouses prefer to have professional management of their inheritance and often use a corporate (bank) Trustee.

3. Some clients have spouses which they feel can be unduly influenced by one or more of their children. A trust created for the surviving spouse will protect the assets for all of the children.

Another provision relating to married couples was included as part of a 2010 Tax Relief Act. For the first time "portability" of the estate tax exemption is allowed. In effect, portability means that, if the estate of the first spouse to die does not use his or her $5,000,000 estate tax exemption, the unused part can be used by the surviving spouse when the surviving spouse dies. For example, if the husband dies first and only $1,500,000 is placed into a trust for the benefit of the surviving spouse, the remaining $3,500,000 unused estate tax exemption can be added to the surviving spouse's estate to apply against her assets when she dies. This means that, in effect, the surviving spouse will have a $8,500,000 exemption when she dies ($3,500,000 of the husband's unused exemption plus $5,000,000 of her own exemption). The importance of this portability cannot be stressed enough. It will allow a largely unplanned estate plan to be "corrected" by eliminating the wasting of the exemption when the first spouse dies by the failure of having assets placed into a trust for the benefit of the surviving spouse.

Finally, in regard to the estate tax law changes, it must be borne in mind that the 2010 Tax Relief Act only extended the $5,000,000 until the end of 2012. After that, once again, the estate tax exemption reverts to $1,000,000 beginning in 2013 and, just as importantly, the portability of the unused estate tax exemption will also be lost. Once again, the U.S. Congress must act in order to avoid the reversion to the old law which was enacted in 2001.

One final thought: Over the years, Ohnstad Twichell attorneys have recommended farmland to be owned by a husband and wife as tenants in common. Tenants in common is a form of co-ownership, which unlike joint tenancy, has no right of survivorship. If, for example, farmland is owned by a husband and wife as tenants in common, if either of them were to die, his or her undivided one-half (½) interest would be devised in accordance with their Will. The large federal estate tax exemption has eliminated estate tax problems for a large number of our estate planning clients. This is particularly true with clients who have a net worth substantially below $5,000,000. These clients who now own their land as tenants in common should instead consider separate ownership of their land. In other words, the husband and wife should each own specific parcels of farmland separately. This suggestion is for *income tax purposes.* Farm real estate is given a new cost basis when an individual dies. For example, if an individual purchased farmland a number of years for $500 per acre and that same farmland is appraised at $1,500 per acre when the individual dies, the new cost basis is stepped up to $1,500 per acre. Thereafter, if the farmland is sold by an heir, the heir only has to pay capital gains taxes on the difference between $1,500 per acre and the sales price, rather than the difference between $500 per acre and the sales price. Therefore, significant capital gains taxes are saved in the event farmland is later sold. On the other hand, if that same farmland was owned as tenants in common by one of the spouses when the spouse died, it would not be unusual for the appraiser to discount the fair market value by as much as 20%. A 20% discount reduces the amount of the step up in cost basis, thereby creating additional capital gains taxes if the farmland is later sold. In other words, with a large estate tax exemption of $5,000,000, the focus for many individuals is no longer estate tax savings, but rather income tax savings. Separate ownership will eliminate the discount in fair market value, resulting in a larger cost basis while still not creating estate tax because of the large estate tax exemption. In summary, clients who have a net worth substantially less than $5,000,000 should consider contacting their Ohnstad Twichell attorney to determine whether or not their farmland should be transferred out of tenants in common and placed into the individual names of the husband and wife.

2010 Tax Relief Act only extended the $5,000,000 until the end of 2012.

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PROFILE OF ATTORNEY

AMANDA N. JUELSON

Amanda N. Juelson *works in the Hillsboro office and devotes her practice to family law, real estate law, estate planning and probate.*

Amanda N. Juelson joined the Ohnstad Twichell law firm in September 2010. She maintains a general practice of law which includes trusts and probate, real estate, estate planning, agricultural law, criminal law, and family law.

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ADDRESS SERVICE REQUESTED

Amanda is a native of Hillsboro, ND. She received her undergraduate education at Minot State University with a Bachelor of Arts and Sciences degree with a double major in Spanish and Criminal Justice, cum laude honors. Amanda received her J.D. from the University of North Dakota in 2010. While attending UND Law, Amanda worked as an intern at the Ground Forks County State's Attorney's Office and at the Grand Forks Air Force Base J.A.G. area defense counsel office.

Amanda is located in the Hillsboro office.

She enjoys spending time with family and friends, traveling, going to the lakes, water and snow skiing, learning to golf, outdoor activities, shopping, and music.

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NEWS FROM OHNSTAD TWICHELL

Sean M. Fredricks will be presenting "Water Law Jurisdiction" for the North Dakota Association of Counties on July 13 in Bismarck.

Brian D. Neugebauer was recently elected President of the Minnesota Municipal Attorneys' Association.

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Sara K. Sorenson has an article published in the latest edition of the North Dakota Law Review. The article is entitled: A Need for Clarification: North Dakota's Abandoned Mineral Statute. The article is at Volume 86, Number 3, and it can also currently be found at the North Dakota Law Review's website: http://web.law.und.edu/LawReview

GETTING PERSONAL!!

Stacy J. Schwientek joined Ohnstad Twichell in April of 2011 as an office assistant. She graduated from the Minnesota School of Business in June 2010 with an Associate's Degree in Paralegal. Stacy completed an internship at the St. Cloud City Attorney's Office where she worked mostly in criminal law. Shortly after graduating Stacy moved to Fargo from St. Cloud, MN. She previously worked at Kohl's Department Store where she enjoyed volunteering in the Kohl's Kares for Kids programs throughout the state. In her free time Stacy enjoys going back home to visit family and spending time outdoors working on projects.

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