

Probate & Trust Law Newsletter

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

A Word From the Chair

The fall issue of the *Probate & Trust Law Newsletter* would be incomplete without mention of the Section Conference, which took place on June 9 and 10. Once again, the faculty and planners helped produce a tremendous conference and for that they deserve our thanks.

This newsletter highlights recent developments in state and federal law and the new composition of the Probate and Trust Law Section Council.

The purpose of the newsletter is to serve as a medium through which the Probate & Trust Law Section and the Minnesota estate planning bar can communicate. It is published semi-annually. The newsletter consists of articles on legal developments and legislative updates, announcements of Section activities and events, and information regarding Section contacts. We welcome your comments and the submission of articles or announcements for future newsletters.

Important Numbers for 2005

<u>Federal Estate/GST Tax Exemption</u>	\$1,500,000
<u>Federal Gift Tax Exemption</u>	\$1,000,000
<u>Minnesota Estate Tax Exemption</u>	\$950,000
<u>Annual Gift Tax Exclusion</u>	\$11,000
<u>Maximum Federal Gift/Estate Tax Rate</u>	47%
<u>GST Tax Rate</u>	47%
<u>Maximum Minnesota Estate Tax Rate</u>	16%
<u>Maximum Federal Income Tax Rate</u>	35%

Legislative Update

(Peter S. Hatinen)

It was an active legislative session. The legislature passed several bills of note in both the main session and a special session.

Passed Bills

A. Senate File 392 (approved by the Governor on April 22, 2005).

Senate File 392 makes two changes to Chapter 501B of the Minnesota Statutes. First, it loosens venue requirements for trust proceedings by amending Minnesota Statute § 501B.17 to provide that petitions regarding trusts with corporate trustees may be filed in any county in which the corporate trustee "has a trust office." The section previously provided that such petitions had to be filed in the county in which the corporate trustee had its "main office."

Senate File 392 also broadens a trustee's power to make adjustments between income and principal. Effective as of January 2, 2004, the Treasury Regulations under IRC § 643(b) were amended to provide that "an allocation of amounts between income and principal pursuant to applicable local law will be respected if local law provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust for the year, including ordinary and tax-exempt income, capital gains, and appreciation." Senate File 392 amends Minnesota Statute § 501B.705 so that it reflects the Treasury Regulations by explicitly permitting a trustee to consider total investment returns from all portfolios when making adjustments between income and principal and by removing the limitation on a trustee's power to make such adjustments on marital trusts.

Senate File 392 also makes one significant change to the Uniform Probate Code. Until recently, it was not apparent that the Minnesota omitted child statute made no provision for the

issue of an omitted child in the event that the omitted child predeceases his or her parent. Thomas J. Woessner, Section Council Treasurer, brought this oversight to the attention of the Legislation Committee and the statute has now been corrected. Senate File 392 amends Minnesota Statute § 524.2-302(d) to provide that “If a deceased omitted child would have been entitled to a share under this section if the omitted child had not predeceased the testator and the deceased omitted child leaves issue who survive the testator, the issue who represent the deceased omitted child are entitled to take the deceased omitted child’s share.”

B. House File 2228 (approved by the Governor on June 2, 2005).

House File 2228, as amended by a Senate Conference Committee (SH 2228, A.50), makes several tax-related changes to the Minnesota Statutes. First, it makes automatic the granting of the six month extension to file Minnesota estate tax returns by amending Minnesota Statute § 298A.19, subdivision 4 to provide “If the estate requests an extension to file an estate tax return within the time provided in section 298A.18, subdivision 3, the commissioner shall extend the time for filing the estate tax return for six months.” This provision is effective for estates of decedents dying after December 31, 2004.

House File 2228, as amended, also makes more precise the definition of a “resident trust” by adding paragraphs (b) and (c) to Minnesota Statute § 290.01, subdivision 7b which read as follows:

“(b) ...A trust...is a resident trust only if two or more of the following conditions are satisfied:

- (i) a majority of the discretionary decisions of the trustees relative to the investment of trust assets are made in Minnesota;
- (ii) a majority of the discretionary decisions of the trust relative to the distributions of trust income and principal are made in Minnesota;

- (iii) the official books and records of the trust, consisting of the original minutes of trustee meetings and the original trust instruments, are located in Minnesota.

(c) For purposes of paragraph (b), if the trustees delegate decisions and actions to an agent or custodian, the actions and decisions of the agent or custodian must not be taken into account in determining whether the trust is administered in Minnesota, if:

- (i) the delegation was permitted under the trust agreement;
- (ii) the trustees retain the power to revoke the delegation on reasonable notice; and
- (iii) the trustees monitor and evaluate the performance of the agent or custodian on a regular basis as is reasonably determined by the trustees.”

This provision is effective for tax years beginning after December 31, 2004.

The winter issue of this newsletter highlighted the fact that, as of January 1, 2005, the federal credit for state estate taxes was phased out and replaced with a deduction for such taxes. This was problematic because the Minnesota estate tax was calculated based upon a decedent’s federal adjusted taxable estate, which is the decedent’s gross estate reduced by, among other things, state estate taxes. To prevent a circular Minnesota estate tax calculation, House File 2228, as amended, adds paragraph (9) to Minnesota Statute § 291.005, subdivision 1, which defines the Minnesota adjusted taxable estate as the federal adjusted taxable estate, increased by the deduction for state estate taxes. Minnesota Statute § 291.03, subdivision 1 is also amended so that the calculation of the Minnesota estate tax is based upon the newly defined Minnesota adjusted taxable estate, rather than the federal adjusted taxable estate. These changes are applicable to the estates of decedents dying after December 31, 2004.

C. House File 2448 (approved by the Governor on June 3, 2005).

House File 2448, as amended by a Senate Conference Committee (SH 2448, A-3), adds a provision to the Minnesota Statutes that is intended to treat irrevocable trusts created by an individual or an individual's spouse as available assets for purposes of determining the individual's eligibility for medical assistance. The bill adds Minnesota Statute § 501B.895 which, in part, provides:

“(b) When a state or local agency makes a determination on an application by the individual or the individual's spouse for payment of long-term care services through a Minnesota public health care program pursuant to chapter 256B, any irrevocable inter-vivos trust or any legal instrument, device, or arrangement similar to an irrevocable inter-vivos trust created on or after July 1, 2005, containing assets or income of an individual or an individual's spouse...becomes revocable for the sole purpose of that determination.”

The Legislation Committee was actively involved in negotiating and limiting these changes as proposed by the Department of Human Services. As indicated in the excerpt above, the law is effective for trusts and similar devices created after July 1, 2005. The new statute incorporates United States Code, title 42, § 1396p, and therefore may not reach back more than five years from the date an individual applies for medical assistance.

After a series of amendments to the new statute during the special legislative session, it is not clear whether Minnesota Statute § 501B.895 was amended or repealed. After reviewing the legislation passed during the special session, the Revisor of Statutes appended an asterisk (*) to the new statute, indicating that it is subject to “other actions.” The Revisor has not taken a position on whether the statute was repealed or amended. The Probate and Trust Law Section Council believes that the statute may have been

repealed, but it anticipated that the Department of Human Services will take a contrary position.

D. House File 1481 (approved by the Governor on June 3, 2005)

House File 1481 amended Minnesota Statute § 524.5-310 to provide that a guardian shall send or deliver to its ward notice of the right to request termination or modification of the guardianship and notice of the status of the ward's right to vote.

Tabled Bills

A. House File 785 (not passed)

The legislature did not consider conforming the Minnesota estate tax with the federal estate tax because the revenue cost of doing so was estimated to be \$65,000,000. However, the legislature did consider adopting a state QTIP election. House File 785 contained a provision that would have established a mechanism for making such an election. However, the bill was ultimately tabled and not passed.

Federal Update *(Peter S. Hatinen)*

A brief summary of some noteworthy federal developments follows:

A. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 affects many asset-protection techniques used by nearly all estate planners.

Section 548 of the new bankruptcy code sets forth a fraudulent transfer rule that is applicable to self-settled trusts. The new law provides that a creditor in a bankruptcy proceeding may avoid any transfer of an interest of the debtor in property that was made within 10 years of the filing of a bankruptcy petition if (i) the transfer was to a self-settled trust or similar device, (ii) the transfer was by the debtor, (iii) the debtor is a beneficiary of the trust, and (iv) the debtor

made the transfer with the intent to hinder, delay, or defraud any entity to which the debtor was or becomes indebted.

The new law defines a self-settled trust as a trust in which the settlor remains eligible to receive distributions of income and/or principal. A transfer is defined as a transfer made in anticipation of any money judgment, settlement, civil penalty, equitable order, or criminal fine incurred by, or which the debtor believed would be incurred by, violations of federal or state securities laws.

Given the forgoing provisions, it is not clear whether the new law applies to GRATs, QPRTs, CLTs, or similar trusts. To prevent the application of the new law to such instruments, estate planners should maintain a record of the client's reasons (other than pure asset protection) for establishing such instruments.

Section 522(b) of the new bankruptcy code addresses retirement plans. In general, assets in qualified plans are excluded from the bankruptcy estate, and direct transfers between such plans remain excluded. However, such plans (other than SEP and SIMPLE IRAs) are excluded only to the extent of \$1,000,000.

Sections 522(o) through 522(q) of the new bankruptcy code address the homestead exemption. The new law precludes a potential debtor from sheltering his or her wealth in a newly acquired home. Under section 522(p), the value of the homestead of a debtor in excess of \$125,000 is no longer exempt until the debtor has owned the home for 3 years and 4 months. Section 522(q) of the new law includes the entire value of the homestead in the bankruptcy estate if the debt is related to (i) a violation of federal or state securities laws, (ii) the purchase of registered securities through fraud, deceit, or manipulation, (iii) a violation of civil RICO laws, or (iv) any criminal act, intentional tort or willful or reckless misconduct that causes serious physical injury or death in the preceding 5 years. Finally, section 522(o) provides that if within the 10 years preceding a bankruptcy filing the debtor converted non-exempt property to a homestead with the intent to hinder, delay,

or defraud a creditor, the value of the homestead exemption is reduced by the value of such converted property.

B. Circular 230

On June 20, 2005, the final regulations governing the rules of practice before the IRS became effective. The regulations, commonly known as Circular 230, set forth the rules applicable to "covered opinions." A covered opinion is written advice concerning one or more federal tax issues arising from a (i) listed transaction, (ii) any plan where avoidance or evasion of tax is a principal purpose, or (iii) any plan where avoidance or evasion of tax is a significant purpose, if the written advice constitutes a reliance opinion, a marketed opinion, is subject to confidentiality, or is subject to contractual protection.

Covered opinions must adhere to the following standards:

- They must identify and consider all relevant facts and not base an opinion on any unreasonable assumptions or representations;
- They must relate the applicable law to the relevant facts and not rely on any unreasonable legal assumptions;
- They must evaluate all significant federal tax issues and reach a conclusion, supported by the facts and the law, as to the likelihood that the taxpayer will prevail on the merits with respect to each significant federal tax issue; and
- They must provide an overall conclusion as to the federal tax treatment of the tax shelter items and the reason for such conclusions.

Unless written advice concerns a listed transaction or its principal purpose is tax avoidance, it is not treated as a reliance opinion, provided that the practitioner prominently discloses that it is not intended and cannot be

used by the taxpayer to avoid penalties that may be imposed. Therefore, to keep most written, tax-related communications from falling within the Circular 230 requirements applicable to covered opinions, tax practitioners may attach disclaimer legends on such correspondence. An example of such a disclaimer follows:

“To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code, or (ii) promoting, marketing, or recommending to another party any matters addressed herein.”

C. Rev. Proc. 2005-24

Revenue Procedure 2005-24 addresses the interaction of the regulations regarding charitable remainder trusts and spousal rights to elect a share of the decedent’s “augmented estate.” A CRT’s tax exempt status is based upon the assumption that the remainder interest of the trust will pass to charity. The IRS is now concerned that in many states, the surviving spouse’s right to elect a share of the decedent’s augmented estate may permit the surviving spouse to reach the remainder interest in a CRT because the augmented estate is defined to include lifetime gifts.

In response to the Service’s concern, the Revenue Procedure provides that for trusts created on or after June 29, 2005, the failure of the donor’s spouse to waive the right of election will result in the trust failing to qualify as a CRT, whether or not the right of election is exercised, if state law granted the survivor a right to elect against the trust property. Therefore, the spouse of the grantor must waive his or her right of election in those states in which the right of election is such that it reaches lifetime gifts or the augmented estate. The waiver must be valid under applicable state law, in writing, and signed and dated by the spouse. CRTs created before June 28, 2005 are

exempted from this requirement. However, they will still lose their tax exempt status if the surviving spouse exercises his or her right of election over the CRT.

Hurricane Katrina Relief

The Minnesota State Bar Association is responding in several ways to the needs of the Gulf Coast legal community as a result of Hurricane Katrina. If you are interested, there are three specific opportunities for you to contribute to that effort:

A. Contribute Funds. – The Minnesota State Bar Association Foundation is contributing funds both for humanitarian efforts and, through the various state bar association foundations, to assist with the rebuilding of the legal infrastructure. You may contribute to that effort by sending a check payable to the MSBA Foundation. If you want to designate those funds for the efforts to rebuild the Gulf Coast legal infrastructure, you should note that with your contribution. You should send your contribution to Minnesota State Bar Foundation, 600 Nicollet Mall, Suite 380, Minneapolis, MN 55402-1039 (Attn: Katrina Relief).

B. In-Kind Donations. – If you have used office furniture, computers, or other material that can assist displaced attorneys in the Gulf Coast states, the MSBA is collecting and shipping those materials. For more information about in-kind donations, please contact Sheryl Ramstad at (651) 296-2806 or sheryl.ramstad@taxcourt.state.mn.us.

C. Pro Bono Opportunities. – To the extent that Minnesota receives evacuees from the Gulf Coast states, the MSBA is preparing to have the resources to provide pro bono legal services to those evacuees. If you are interested in participating, please contact Caroline Palmer at (612) 278-6308 or cpalmer@mnbar.org.

Probate & Trust Section Council Meeting Dates

The Council is scheduled to meet on the following days:

October 13, 2005	February 16, 2006
November 17, 2005	March 16, 2006
December 15, 2005	April 20, 2006
January 19, 2006	May 18, 2006

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

The Gene Daly Award

The Gene Daly Award is periodically conferred upon Section members who have made a strong, positive impact on the practice of estate planning in Minnesota. Faith Ohman was given the award in 2005. If you would like to nominate someone for the award, please contact Andrea Breckner.

Probate & Trust Section Committees

Several Committees develop and implement various programs of the Probate & Trust Law Section. Volunteers interested in becoming involved in a committee are encouraged to contact the chair of the committee on which they wish to serve. Furthermore, anyone willing to serve as the chair of the Technology committee is encouraged to contact Kip Steincross. The Section committees and their chairs are as follows:

Education, Thomas J. Woessner

Legislation, Mary E. Shearen and Robert A. McLeod

Newsletter, Peter S. Hatinen

Litigation Committee, Alan Silver

Federal Taxation, Scott Nelson

Consumer Protection/Publications, Mavis J. Van Sambeek

Greater Minnesota Involvement, Bradley W. Hanson

Technology, Open

Gene Daly Award, Andrea Breckner

Ethics and Professional Responsibility, Susan J. Link

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