Introduction:
Estate planning is the process of controlling your assets during your life as well as after your death. Your estate plan should focus on three objectives. Those objectives are: 1) to ensure that your assets will provide you with the necessary income and resources upon which to live, 2) to ensure that upon your death, your assets go to the people and/or organizations you intended, and 3) to minimize your estate tax, fees, and any associated court costs.

Estate planning encompasses many components. Life insurance amounts, policy ownership, and beneficiaries must be reviewed. Property ownership must be examined and tailored to your plan. Your will or revocable living trust must be adapted or changed to meet your objectives. Family income requirements must be matched with projected income. Other items to consider include fair treatment of heirs, passing on any business you may own to business heirs, tax minimization, administrative and probate cost savings.

Estate planning is an ongoing process. As tax laws change and as life situations change, review of your estate plan is crucial.

Who Needs An Estate Plan?
Many people feel that estate planning is for the elderly or the rich or is not something they want to discuss because it focuses on death. No one knows what the future holds and so it is important that everyone have a plan.

For the young married couple with children, it is crucial to have a will that designates guardians for those children in the event both parents are killed. For the person who thinks they do not have enough money to worry about estate planning but have lots of life insurance, their death can create an estate tax problem. A person who is injured in an accident and suddenly is not capable of making their own medical and financial decisions, can name an individual who will make those decisions for them.

The bottom line is that estate planning is important for everyone.

Property Ownership:
Property in Minnesota can be held in several ways. The method chosen depends upon the individual’s estate plan and how they wish their property to transfer to their heirs. Following is a list and description of the ways property can be held.

Sole ownership is the simplest form of ownership. One person owns the property. Upon their death, the property passes via their will. If they have no will, state law dictates how assets are transferred to the designated heirs.

Joint tenancy ownership is ownership between two people. They own the property together and upon the death of one joint tenant, the surviving joint tenant receives the decedent’s property. To create joint tenancy, specific wording is necessary on the ownership documents. Typical wording is “John and Mary Doe, as joint tenants with rights of survivorship, not as tenants in common” for joint tenancies established after December 31, 1976.

Upon the death of one joint tenant, his/her portion of the property is included in the estate for estate valuation purposes. Joint tenancy property is not subject to the probate process. However, this is a complex area of tax law. Check with your attorney.

Tenancy in common allows two or more people to own property together. Upon the death of any tenant, the decedent’s portion of the property does not go to the survivor. That property passes via the decedent’s will or by state law. At the time of death, the value of the decedent’s portion of the property is included in his/her estate and is subject to the probate process.

A granted life estate is another form of ownership. It is usually done through a will or living trust. A person can hold title to property as a life tenant or as a remainderman. For example, if a husband passes land in
his will to his children, but with a life estate (life use) to the wife, the children are the remaindermen and the wife is the life tenant. The wife receives all income from the property and must manage, maintain and pay all property expenses on it during her lifetime. Upon her death, the property passes outright to the children without being included in her estate. The property would receive a “stepped up basis” (valued at fair market value) on the date of the death of the husband.

A retained life estate occurs when a living person gifts an asset they own to their heirs while at the same time they retain a life estate or lifetime use of the property until their death.

Example: A mother might gift her personal residence or farmland to her children. She reserves the right to live in the house or receive income from the farm as long as she lives. Upon her death the property passes completely to the children. It would be included in her estate and receive a stepped up basis upon her death.

Probate/Non-Probate Assets:
The probate process is established to prove that the decedent’s will is valid, to pay any debts held by the estate, to establish clear title to any assets, and to pay any necessary income or estate taxes. Solely owned property and property owned as tenants-in-common are subject to the probate process. Joint tenancy property, life insurance not owned by the decedent going to beneficiaries other than the estate, and revocable living trust property are not subject to the probate process.

The probate process can be time consuming and costly as well as making the decedent’s estate information public. How property is held will dictate if the probate process applies or not.

Federal Gross Estate:
Estate taxes will be assessed on any estate that exceeds the Unified Estate and Gift Credit, referred to as the unified credit. This amount varies by year. The current amounts are listed in the following table by year:

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002-03</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>2004-05</td>
<td>$1,500,000</td>
</tr>
<tr>
<td>2006-08</td>
<td>$2,000,000</td>
</tr>
<tr>
<td>2009</td>
<td>$3,000,000</td>
</tr>
<tr>
<td>2010</td>
<td>No limit</td>
</tr>
<tr>
<td>2011</td>
<td>$675,000 – if no legislative action</td>
</tr>
</tbody>
</table>

An individual’s Federal Gross Estate includes all property held at death. It will include all stocks, bonds, cash, land, machinery and other assets. The assets are valued at fair market value (FMV) as of the date of death or as of six months after the date of death if it is more advantageous for tax reasons.

Deductions From Federal Gross Estate:
Certain deductions are allowed against the gross estate. Those include debts owed by the decedent, funeral costs, administrative costs and last medical costs can be subtracted from the gross estate. Some examples of those deductions follow:

1) Marital Deduction:
A married person can pass any amount of estate assets to their spouse, free of any estate tax. It is a deduction from the gross estate and is one of the biggest federal estate tax saving devices. The marital deduction is not available to the estates of widows, widowers or other unmarried persons. In a carefully constructed estate plan for a married couple, little or no estate tax is payable upon the first death. Each individual would will up to $1,000,000 (2003) to other heirs, with the balance going to their surviving spouse using the marital deduction.

Example: Wife dies in 2003 leaving a total estate of $1.75 million. If she willed $750,000 to her children and $1.0 million to her husband, no estate taxes would be paid upon her death. The surviving husband (not remarried) may or may not have an estate tax problem depending upon the value of his estate at the time of his death. Since he has no spouse on which to use a marital deduction, he is limited to the unified credit amount in effect the year of his death.

2) Charitable Deduction:
The value of any property passing to qualified charities is deductible from the gross estate.

Federal Estate Tax Calculations (Simplified):
Assume a husband dies in 2003 leaving a gross estate of $1,400,000. He has estate settlement costs of $30,000, debt of $100,000, a marital deduction of $800,000 and a charitable deduction of $50,000.

Calculation:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Estate</td>
<td>$1,400,000</td>
</tr>
<tr>
<td>Debt</td>
<td>- 100,000</td>
</tr>
<tr>
<td>Deductions</td>
<td>- 30,000</td>
</tr>
<tr>
<td>Charitable deductions</td>
<td>- 50,000</td>
</tr>
<tr>
<td>Marital Deductions</td>
<td>- 800,000</td>
</tr>
<tr>
<td>Adjusted Taxable Estate</td>
<td>$ 420,000</td>
</tr>
</tbody>
</table>

Since the taxable estate is under $1,000,000 (2003), there is no estate tax due.
**Federal Estate Tax Rates:**
For taxable estates over $1,000,000 (2003), the tax rate is 49%. That rate changes as follows:
- 2004 – 48%
- 2006 – 46%
- 2008 – 45%
- 2009 – 45%

In 2010 the estate tax is eliminated and only the gift tax of 45% remains. In 2011, the rules revert back to the 2001 rules if there is no legislative action taken.

**State Estate Tax:**
In addition to federal estate taxes, there are some states that have estate taxes as well. Most states with estate tax provisions did not raise their exemption amounts to match the federal increase. For Minnesota, the exemption amounts are as follows:
- 2003 - $700,000
- 2004 - $850,000
- 2005 - $950,000
- 2006 and beyond - $1,000,000

Consult with your accountant or attorney regarding the state estate tax issues as they relate to your situation.

**Special Use Valuation (SUV):**
Farmland is one asset that can be valued not at FMV, but at a Special Use Valuation (SUV) if the estate meets several complex qualifications. SUV usually results in a lower valuation than FMV and may possibly reduce an estate tax obligation.

SUV is calculated by taking the land rental rate for comparable land minus the real estate taxes paid, divided by the AgStar average annual effective interest rate.

**Example:** land is appraised at $2,150 (FMV) per acre with real estate taxes of $20 per acre, cash rent of $130 per acre, and an AgStar effective interest rate of 9 percent. The SUV calculation is as follows:

\[
\text{SUV} = \frac{\text{Cash rent} - \text{Real estate tax}}{\text{AgStar interest rate}} = \frac{130 - 20}{0.09} = \frac{110}{0.09} = 1,222/acre
\]

Using the SUV on this land could save estate taxes on $928/acre. **Note:** 1) SUV should not be used on estates that are less than the unified credit for the year in question. Doing so may result in a lower than necessary tax basis as well as unwanted rental and sale restrictions. 2) The business must be in compliance with the SUV rules for 10 years or you lose the SUV designation.

**Family Owned Business Exclusion:**
The Family Owned Business Exclusion (FOBE) was enacted in 1997. It allows owners of family owned farms and businesses a larger exemption from estate taxes. If your assets at death qualify for this exemption, you can have an estate of $1.3 million (rather than the $1.0 million in 2003) and pay no estate taxes. To qualify, the decedent must:

1. Have been a U.S. citizen.
2. Have business property which exceeds 50% of the adjusted gross estate.
3. Must have owned and materially participated in the family business (this requirement could also be met by a member of the decedent’s family).
4. Pass or sell the property to a qualified heir.

The qualified heir must continue to materially participate and continue to own the qualified property for 10 years following the death of the decedent.

The FOBE became effective 12/21/97 and was modified in 1998 by Congress. It ends in 2003 because of unified credit increases to $1,500,000 in 2004-2005. It is a highly complex tax law with many areas of uncertainty. Check with your attorney if you choose to use this provision.

**Other Considerations:**
1) **Power-of-Attorney** - adding a provision in your will granting someone Power-of-Attorney in the event you are incapable of making financial decisions is a good idea. The individual or individuals can manage your assets in your best interest if you are unable to do so.

2) **Health Care Directive** – writing and attaching a Health Care Directive to your will ensures your wishes for health care are honored in the event you are incapable of expressing your wishes. You decide what level of health care you want in a given situation and place those wishes in effect via the Health Care Directive. Many hospitals and health care providers have information on developing the care directive as well as forms to complete.

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**Caution:** This publication is offered as educational information. It does not offer legal advice. If you have questions on this information, contact an attorney.

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