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ESTATE PLANNING

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NORTH DAKOTA PUBLIC EMPLOYEE RETIREMENT SYSTEM ESTATE PLANNING SEMINAR

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ESTATE PLANNING

Estate planning is deciding during your life what will happen to your property when you die. Everybody plans their estate one way or another. The use of a will is estate planning, but also deciding not to have a will is estate planning. So everybody, as they go through life, is planning their estate, whether they know it or not; whether they do it consciously or unconsciously. But proper estate planning can minimize current and future estate taxes and preserve estates while satisfying ones personal needs and desires.

Because everybody's estate is different, different decisions must be made. To know what decisions to make, one must have knowledge of the different alternatives available in estate planning. Estate planning can be divided into four main areas.

I. THE WILL
II. PLANNING
III. PROBATE
IV. TAXES

I. THE WILL

There are three major reasons for having a will. First, and most importantly, is to assure that your property passes to the people that you want. The second reason is to save taxes, and the third reason is to provide stability and certainty.

Though everybody knows about wills, a significant number of people die without one. If you die without a will, then your estate passes to your heirs according to the statute of ***Intestate Succession***. Intestate means dying without a will. In North Dakota, when a person dies (referred to as a "decedent"), the entire estate passes to the surviving spouse if there are no surviving children and no surviving parents or if all of decedent's surviving descendants are also descendants of the surviving spouse. If the decedent had children from a previous marriage, the surviving spouse gets the first $100,000 and the remainder of the estate is divided 50-50 with the children of the decedent. If there are no children, the surviving spouse gets the first $200,000 and three-fourths of the remainder. The other 25% passes to the parents of the decedent. If there are neither parents nor children, then it would go to brothers and sisters, or nieces and nephews, or to aunts and uncles, in that order. If there are no persons to take under the statute, then all of the property goes to the state.

This type of distribution may be just what the average person might want. Therefore, he may say that he doesn't need a will. But there are other aspects of a will that are important, and should be considered before determining whether or not to have a will.

A. Guardians

One major non-tax reason for a will concerns minor children. If a couple has young children, they should be concerned that the children are looked after in the event of premature death of the parents. Through the will, the parents can specify who is to be the guardian of the children in such a case. This use of the will can prevent a lot of problems of determining guardians, and can usually ensure that the guardians that the parents want will be appointed. Another important function of the will as it relates to minor children is the establishment of a trust for minor children if both parents should pass away. This trust would provide for the children and would designate an age (i.e. 21, 23, 25) when the property can be distributed outright to the children.

B. Specific Bequests

Another non-tax reason for a will concerns specific bequests. If a person wants to leave something to a non-relative at death, a will is essential. Also, if you want someone to have a specific item at your death, the only way to assure this is through a will. North Dakota has a statute which allows a person to prepare a ***list*** in conjunction with his will, designating where items of personal property are to go upon death.

C. Certainty

Another important aspect of a will is the certainty that it provides. A person may be happy with the way his property would be distributed under state laws now, but those laws can be changed, and a change may cause the estate to be distributed in a manner different than what the decedent would have wanted. The use of a will can provide certainty that a person's estate will be distributed according to his wishes.

D. Personal Representative

Another non-tax reason for having a will is the opportunity to appoint a personal representative. Since the personal representative will be in charge of seeing that the bills are paid, the estate is distributed, and tax returns filed, he is a very important person. Through the will, a person can ensure that a personal representative of his choice will be appointed.

E. Decreased Time And Expenses Of Probate

The will can decrease time and expenses of probate by providing that no bond be required by the personal representative, by empowering the personal representative to act without court approval, and by keeping fiduciary fees in the family.

F. Update

The final important non-tax aspect of having a will is that it will start a process of monitoring your estate by your estate planner, so that if changes occur in your circumstances or in tax laws, the proper adjustment can be made. Everyone's will and estate plan should be looked at least ***annually*** to see if it needs to be updated.

G. Execution

The proper execution of a will requires the person making the will to sign in the presence of two witnesses, who must also sign the will. The signatures can then be notarized so that the will is self-proved and the witnesses don't have to testify in court. There is an exception to this. North Dakota allows a person to make what is called a "***holographic***" will. This is a will that is all in the handwriting of the person making it.

Generally, all property of a decedent would pass according to his will, but there is an exception to this. The exception allows the surviving spouse to ***claim a one-half share*** (subject to certain limitations and conditions) of the estate instead of taking under the will. (Prior law allowed a one-third share.) So if a surviving spouse feels that he or she is getting less than one-half, this election can be made. Also, if a spouse is unintentionally ***omitted***, that spouse would receive his or her intestate share.

II. PLANNING

A major function of the will is to aid in the ***tax planning*** of an estate. An individual with an estate under ***$2,000,000 (in 2006-2008)*** does not have to worry about estate taxes. The estate tax exemption for married couples is $2,000,000 per spouse. But as soon as one gets over these amounts tax consequences arise and the will is an essential part of lessening the taxes. A properly drawn will can significantly reduce the estate taxes.

The question in the planning area is whether a person's estate needs to be planned. As mentioned above, if the assets held by an individual are worth $2,000,000 or less, there are no tax consequences at death, and usually no estate tax return is required. In considering the size of your estate, one should consider the effects of inflation, future increases in income, and also any possible inheritances. The effects of inflation alone have caused more and more people's estates to be subject to estate taxes. So planning is much more important today than it was in the past.

The ***ultimate goal*** of any estate plan is to permit the client to use and enjoy his property during life, and to pass the property to his chosen beneficiaries with the least possible shrinkage in value. All estate planning should be done with this goal in mind.

A. Preservation Of Property

The goal of preserving one's property is accomplished in two general ways: (1) by providing liquidity at death, and (2) by keeping death expenses at a minimum.

1. Liquidity

Liquidity means having assets which can easily be turned into cash. The principal means of providing liquidity is through ***life insurance***. This automatically provides cash at death. It is very important to have insurance held in the right way so that it can be available to pay expenses, but doesn't increase the size of the estate. This can be accomplished by having policies on the life of the decedent owned by someone else, and by having the beneficiary of the policy keep the proceeds available to the estate to pay estate taxes or by using a life insurance trust.

2. Keeping Death Expenses At A Minimum

The second method of preserving one's property is keeping death expenses at a minimum. This can be accomplished through the use of different devices, such as the will and trust, and by taking advantage of the existing tax laws.

B. Estate Planning Utilizing Multiple Party Accounts Or Beneficiary Designations

Chapter 30.1-31 of the North Dakota Century Code governs the non-testamentary or non-probate transfers on death. Accordingly, any money or other benefits owned by a decedent before death must be paid, after the decedent’s death, to a person designated in the instrument or separate writing. N.D. Cent. Code 30.1-31-01. Such non-probate

transfers include the non-probate transfer on death of an insurance policy, contract of employment, bond, mortgage, promissory note, certificated or un-certificated security, account agreement, custodial agreement, deposit agreement, compensation plan, pension plan, individual retirement plan, employee benefit plan, trust, conveyance, deed of gift, marital property agreement, or other written instrument of a similar nature. *Id.*

According to North Dakota law, accounts are either single party or multiple party. N.D. Cent. Code § 30.1-31-04. A multi-party account may be with or without a right of survivorship between the parties. *Id.* Both Single party and multiple party accounts may have a P.O.D. designation. *Id.*

1. Multiple Party Accounts

A multiple party account is an account owned by more than one individual, i.e. joint account. During the lifetime of all parties to a multiple party account, the account belongs to the parties in proportionate shares to their net contributions, unless there is clear and convincing evidence of a different intent. N.D. Cent. Code § 30.1-31-08. However, with respect to married parties, in the absence of contrary evidence, the net contribution of each is presumed to be an equal amount. *Id.*

Upon the death of one of the parties of a multiple party account, the funds on deposit belong to the surviving party or parties. N.D. Cent. Code § 30.1-31-09. If two or more parties survive and one is the surviving spouse of the decedent, the amount to which the decedent, immediately before death, was beneficially entitled belongs to the surviving spouse. *Id.* If two or more parties survive and none is the surviving spouse, the amount to which the decedent, immediately before death, was beneficially entitled belongs to the surviving parties in equal shares. *Id.*

These concepts are illustrated in the following example. Allan has an account with $5,000.00 and adds Bob as an owner. As a result, both Allan and Bob have a right to withdraw funds from the account during their lifetimes. However, Bob's creditors during the lifetimes of Allan and Bob do not have a claim against the $5,000.00 as Bob's ownership is determined in proportion to his contribution. Upon the death of either Bob or Allan, the other becomes the unequivocal owner of the funds.

2. P.O.D. Accounts

"P.O.D. designation" means the designation of a beneficiary in an account payable on request to one party during the party's lifetime and on the party's death to one or more beneficiaries, or to one or more party's during their lifetimes and on death of all of them

to one or more beneficiaries. N.D. Cent. Code § 30.1-31-02(8). In other words, an owner of an account who desires for the immediate non-probate transfer of an account upon his death but does not want the intended beneficiary to have current access to the account should establish a P.O.D. account designating a beneficiary. The presentation of a certified copy of a death certificate usually satisfies the financial institution and the asset can be immediately transferred.

In using the same example from above, if Allan does not want Bob to access the account during Allan's lifetime, but would like Bob to benefit upon Allan's death, Allan simply could designate Bob as a P.O.D. beneficiary. In the event Allan wants Bob to access the account for Allan's benefit, Allan could execute a durable power of attorney giving Bob the ability to access the account.

Caution should be exercised to ensure the use of multiple party accounts and P.O.D. designations is consistent with the intent of the individual's overall estate plan. For example, if a married couple establishes a multiple party account with one of their five children and both parents pass away, the entire account would belong to the one child who was an owner of the account. Thus, the child serving as an owner of the multiple party account may receive a greater inheritance from his parents than his remaining siblings.

In the event an account is a single party account without a P.O.D. designation, the amount on deposit would pass according to the decedent's estate, where it would be subject to probate proceedings. N.D. Cent. Code § 30.1-31-09. Similarly, the proportionate share of a decedent's contribution into a multiple party account established without the right of survivorship would be distributed as part of the decedent's estate. *Id.*

III. PROBATE

Probate can be defined as: "A court-supervised distribution of a decedent's property according to his will."

North Dakota has adopted the Uniform Probate Code for probate proceedings and this statute allows much flexibility in administering estates and has decreased probate costs. Though the probate of a will can be informal, it is still time-consuming and there are expenses which people would like to avoid. This has led people to attempt to avoid probate when they can.

A. Probate Avoidance

1. Joint Tenancy

Where property is held in joint tenancy, the surviving joint tenant has a right of survivorship and thus takes the entire property at the death of the co-owner. This avoids probate, executor's fees and other administrative expenses. But creating a joint tenancy may trigger a gift tax or create a higher estate tax and an attorney should be consulted before deciding on this method of avoiding probate.

2. Account beneficiary designations

Designating account beneficiaries may eliminate the need for probate because the assets will pass to the designated beneficiary.

3. Life Insurance

Life insurance, by law, is not subject to probate and administration expenses, and thus is one of the best means of keeping probate expenses down.

4. Irrevocable Trusts

Transferring property to an irrevocable trust during one's life can avoid probate at death since this property does not pass under the will. A gift to an irrevocable trust does not qualify for the annual exclusion because it is not considered a present interest gift, which is a requirement for the annual exclusion to apply. However, if the trust has a "crummey" power, the gift to the trust will be considered a present interest.

Transfers to an irrevocable trust are removed from a person's estate.

5. Revocable Trusts (Living Trusts)

It is possible to transfer property during your life to a revocable trust that will allow your property to be passed to your heirs without having to go through probate. Essentially, the revocable trust acts as a will and provides where the property will pass upon your death. In order to use this type of trust you have to actually transfer title to property to the trust during your lifetime. Since the additional cost of submitting your will to probate is not that great, the use of a revocable trust may be an added expense.

Another benefit of the revocable trust is that information of the transfer of the property does not become available to the public in general as would the probate file. Also, if property is owned in different states, the use of a revocable trust will allow the property in other states to be transferred without having to go through a probate in each of the states. If you do own property in a number of different states, the use of the revocable trust can result in a savings of time and expense.

Since the trust is revocable, any property that is transferred into the trust is still part of your taxable estate unlike the irrevocable trust mentioned above.

5. Life Estate

The creation of a Life Estate in real property may avoid probate, at least for the real property interest, by designating by deed that the property shall pass to the remaindermen designated in the deed upon the death of the life tenant. Although the life estate is valuable estate planning tool in many situations, caution must be exercised, however, because the reservation of a life estate in real property involves the transfer of the remainder interest.

B. Affidavit Procedure

If the probate estate contains no real property and the value of the personal property, less encumbrances, does not exceed $50,000, this property may be distributed by using an affidavit. The affidavit is prepared stating that the estate contains only personal property valued at less than $50,000. The affidavit further names the person who is to receive the personal property. When this affidavit is presented to a person holding the property (i.e. bank or stock broker), that person or entity must turn the property over to the person presenting the affidavit.

IV. TAXES

A. Federal Estate Tax

Federal estate tax is computed by taking the gross estate of the decedent and subtracting certain deductions, thus arriving at a tentative taxable estate. The tax is figured on this amount, ranging from 18% to 47%, and then a tax credit is allowed. This credit amounts to $780,800 for 2006. The $780,800 would eliminate tax on an estate of $2,000,000.

B. Deductions

Some of the deductions allowed are for funeral expenses, administration costs, debts of the decedent and marital deduction (as explained earlier).

C. State Taxes

State taxes consist of the maximum amount allowed against the federal tax as a credit for state death taxes. This tax ranges from .8% to 16% on amounts over $10,000,000.

The personal representative is responsible for filing returns and the federal tax is due within 9 months after death, unless a reasonable cause can be shown for an extension of time to pay. (State tax is due in 15 months.)

In the case of certain qualifying estates consisting mainly of a small business or farm, Internal Revenue Code Section 6166 and 6166A allows the option to pay the estate tax in installments over 10 or 15 years' time. These installment methods of payment can ease the liquidity problem discussed earlier.

ADDITIONAL PLANNING AREAS

I. PLANNING FOR INCAPACITY

Planning for an individual's incapacity is essential to one's overall estate plan and is as equally important as planning one's estate in the event of death. Planning for incapacity may eliminate the expenses associated with establishing a court ordered guardian or conservator and may ease the burden upon the children during such difficult times.

A. Financial Power of Attorney

A valid financial power of attorney authorizes an individual to appoint another to conduct all the individual's business affairs. If drafted properly, the financial power of attorney will even authorize another to act on one's behalf in times of incapacity.

B. Health Care Power of Attorney

A valid health care power of attorney authorizes an individual to appoint another to make any and all health care decisions. A "health care decision" means consent to, refusal to consent to, withdrawal of consent to, or request for any care, treatment, service or procedure to maintain, diagnose or treat an individual's physical or mental condition. The agent's

authority becomes effective only when the principal lacks the capacity to make health care decisions, as certified in writing by the principal's attending physician and filed in the principal's medical record.

C. Living Will

Enables the terminally ill to control end of life decisions regarding the administration or withholding of life-prolonging treatment, nutrition, and hydration. In order for a Living Will to become operative, two physicians must certify that the individual is in a terminal and incurable condition, and that death is imminent.

D. Health Care Directive

The Health Care Directive is a new creation of law effective August 1, 2005 that essentially combines the living will and health care power of attorney. It enables an individual to give more detailed direction with respect to health care and end of life decision-making.

II. NURSING HOME PLANNING (MEDICAL ASSISTANCE)

A. Eligibility Requirements

1. **Resource Limits** - one person - $3,000; two persons - $6,000
2. **Exempt Property Items** - home, clothing, furniture, household goods, one vehicle and a pre-need burial contract up to $5,000
3. **Additional Property Provisions** (Spousal impoverishment rule) - The non-institutionalized spouse may separately own resources up to $101,640 in 2007. This figure is adjusted annually.

B. Omnibus Budget Reconciliation Act Of 1993 (OBRA).

1. Made major changes regarding Medical Assistance.
2. Transfer of assets (effective 10-1-93 for transfer on or after 8-10-93).
   a. Nursing home 36-month look-back period (non-trust)
   b. 60-month look-back for transfers in trust
   c. Average cost of nursing home care for 2007 is $4,865 per month (APPR)
   d. Minimum monthly maintenance needs allowance (MMMNA) for 2007 is $2,267.

e. The maximum Community Spouse Asset Allowance (CSAA) for 2007 is $101,640 while the minimum is $20,328.

C. North Dakota's 2003 And 2005 Annuity Bill.

This bill provides great benefits for couples where one is in the nursing home.

D. Deficit Reduction Act Of 2005

This act passed February 8, 2006. It increases the look back period from three to five years and creates a delayed penalty period for gifts of cash or property. It also allows states to provide very beneficial programs for nursing home insurance.