UNDERSTANDING THE BASICS OF ESTATE PLANNING

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I. INTRODUCTION

The purpose of this outline is to provide readers with a basic understanding of the estate planning process. The outline is designed for Wisconsin residents. Readers residing in other states should be aware that the laws of your state may differ from Wisconsin law.

This outline is intended to provide general educational information for Wisconsin residents only. It is not intended to provide legal advice or opinion relative to specific matters or fact situations. Changes in the law may affect the contents of this document. Readers should not make estate planning decisions based on this outline alone without first consulting with their attorney.

II. IMPORTANT ESTATE PLANNING CONCEPTS

A. What is Estate Planning? "Estate Planning**"** is the process which seeks to maximize the benefits offered in applicable areas of law (such as probate, wills, trusts, taxes, property, insurance, contract law, etc.), while at the same time meeting your wishes for the management of your property and health care decisions during life and the management and disposition of your property upon and after death.

B. What is a Will? A will is a written document in which you indicate how and to whom your "*probate property*" is to be left upon death. Wills may be changed or revoked during life as long as you are mentally competent. Upon death, your Will becomes irrevocable (meaning it cannot be changed or revoked).

C. What is a Trust? You can think of a "trust" as a special type of contract that control property: real estate, cash, stocks, bonds, retirement accounts, LLC interests, jewelry, furniture, vehicles, etc. All trusts have three players: (1) the person who creates the trust–referred to as the "grantor" or "settlor"; (2) the "trustee" who holds legal title to the trust's assets and has the fiduciary responsibility to manage the assets according to the terms of the trust; and (3) the "beneficiary" for and to whom the trustee is managing and distributing the trust assets. Often the goal of a trust is to avoid probate.

D. What is "Probate Property"? Most people don't realize that a Will only determines who receives their "probate property." Probate property are assets that require the assistance of the probate court to approve the distribution of the asset to your beneficiaries or heirs. In general, probate property are those assets that do not have named beneficiaries, are not jointly owned, or are not titled in the name of a trust. Examples of probate property include:

1. **Untitled Assets.** Such as furniture, clothes, jewelry, appliances.

2. **Solely Owned Titled Assets.** Titled assets owned solely by you, such as motor vehicles or real estate. Assets such as bank accounts, life insurance, retirement benefits, stocks, etc., for which you have not explicitly named a beneficiary may name your probate estate as the default beneficiary.

3. **Assets co-owned as Tenants in Common**. For example, a deed to real estate might say "Cathy Client owns a 1/3 tenant in common interest." In this case, when Jane dies, through the probate process, Cathy's 1/3 share of the property is distributed according to her Will (or according to the laws of intestacy), at which point her beneficiaries become co-owners of the property along with the remaining tenant in common owners.

E. What is "Non-Probate Property"? Non-Probate Property are assets that do not require the assistance of the probate court to approve the distribution of the asset to your beneficiaries or heirs. Examples of non-probate property include:

1. **Jointly owned property with rights of survivorship.** Probate property does not include property that you own jointly with another with rights of survivorship (or as survivorship marital property). So, for example, if you and another hold title to a piece of real estate as Joint Tenants, and one of you dies, the deceased owner's interest in the real estate passes to the surviving owner, regardless of what the deceased owner's Will may say. Joint Tenants ownership is commonly used for bank accounts, vehicles, or real estate.

2. **Contractual Assets.** Probate property does not include property that is disposed of at your passing according to a contractual beneficiary designation. Examples of such "contractual assets" include life insurance policies, annuities, IRA's, 401(k)'s, pensions, payable-on-death (POD) accounts, etc. Upon death, our contractual assets are left to whomever you have named as a beneficiary.

3. **Assets Owned in Trust.** Titling assets in the name of a trust will result in the transfer of the assets directly to the trust beneficiaries without the need for probate administration. Naming a trust as a beneficiary of certain assets may also accomplish the same. Upon death, the Successor Trustee signs any documents required to complete the transfer (for example, Trustee's Deed, Transfer by

Affidavit, Termination of Trust, etc.). <u>See more information on Trusts below.</u>

F. What Does It Mean to Probate an Estate? Upon death, the deceased's estate must be probated if he/she had probate property in his/her estate (in this context, "estate" refers to all property owned at death). The person that probates your estate is called the "personal representative" ("PR") (also known as the "executor"). For estates with few and simple probate assets, the process can be relatively simple and inexpensive. For larger estates, probate can take a long time and involve large fees.

In very general terms, the process begins with the delivery of your will to the probate court. This is usually accompanied by an application to the court requesting that the estate be probated and that the PR be appointed. If there is no will, then a spouse or other family member typically steps forward and files the application requesting that the estate be probated and that they are appointed as PR.

Various other documents must also be prepared and filed. Notice is given to all "interested parties" (generally, those who would take the property if you died without a will – see intestacy discussion below) and a hearing is set to determine if anyone objects to the PR or contests the will. Assuming there are no objections, notice to creditors is published in the newspaper and creditors have several months to file a claim against the estate. The PR also files or exhibits to the probate court an inventory of your probate assets, showing the date of death fair market value. Assets are gathered and an estate checking account is typically opened. Final tax returns are filed (such as income, fiduciary, and estate tax returns). Creditors are paid off and/or claims are settled. Property may need to be sold to pay claims or facilitate the transfer.

Once all this is done, the PR then distributes the remaining probate assets to the heirs in accordance with the terms of your will. The PR then gets receipts from the heirs and files them with the court along with a request to close the estate, a final accounting, and any necessary documents showing that all taxes have been paid. The court reviews the estate and if it satisfied that the process is complete, it will close the estate and discharge the PR. Statutes give the PR 18 months to complete the probate process. In our experience, probate typically takes between 6 - 12 months.

F. What Happens If You Die Without a Will? If you die without a will, the state legislature has been kind enough to prepare a set of rules that determine this for you. They are known as the "rules of intestacy." They represent how the legislature believes most people would want to leave their probate assets upon death. Here is a general description of how your probate assets get distributed if you die without a will:

1. If your spouse survives you, it all goes to your spouse, unless you have issue ("issue" refers to lineal descendants, that is, a person's children, grandchildren, great-grandchildren, etc.) from a different relationship.

2. If your spouse survives you and you have issue from a different relationship, then ½ of your probate property goes to your surviving spouse and the other ½ of the probate property goes to your issue.

3. If you have no surviving spouse, then all the probate property goes to your issue.

4. If you have no surviving spouse and no surviving issue, then all of the probate property goes to your surviving parents.

5. If you have no surviving spouse, surviving issue, or surviving parents, then all of the probate property goes to your surviving brothers and sisters and to the surviving issue of a deceased brother or sister (your nieces and nephews).

6. If you have no surviving spouse, surviving issue, surviving parents, or surviving issue of your parents, then you probate property gets divided into two equal shares, with one share going to your maternal grandparents and the other to your paternal grandparents. If either set is deceased, then their share goes to their surviving issue (your aunts, uncles, etc.). If either set is deceased and survived by no issue, then their share goes to the other set of grandparents (or their issue).

7. If none of the above survives you, then your probate assets get distributed to the state, to be added to Wisconsin's school fund.

G. What Types of Trusts Are There? There are many different types of trusts. In general, however, we can divide them into groups:

1. **Testamentary Trusts.** These are trusts that are set forth in your will. Testamentary trusts remain as empty shells until the testator dies and the Will is admitted to probate. After death, assets then get placed in the trust according to the terms of your Will and via other methods, such as naming the trust as the beneficiary of a contractual asset, such as life insurance.

2. **Non-Testamentary/Living Trusts.** These are trusts you create during lifetime in a document separate from your Will. These trusts take many forms and are either revocable or irrevocable. As the name suggests, revocable trusts may be amended and revoked at any time while you are alive and competent. Upon death, revocable trusts become irrevocable. Many revocable, non-testamentary trusts are commonly referred to as "revocable living trusts" (which are discussed in more detail below). Irrevocable trusts, on the other hand, cannot be changed once irrevocable.

3. **Subtrusts.** When you start talking about trusts, it can get a bit confusing. One reason for this is because a written trust document can have one or more other trusts or subtrusts drafted into it. For example, a trust can also contain within it

provisions that allow for the creation of other trusts under certain conditions. For example, a living trust or testamentary trust can contain within it a subtrust for a surviving spouse (at the first spouse's death, his/her assets are left to the surviving spouse in a new trust). And, to continue with the example, at the surviving spouse's death, the testamentary trust or living trust can provide yet another subtrust for children or grandchildren.

H. Wisconsin's Marital Property Act.

Under the Wisconsin Marital Property Act, effective January 1, 1986, Wisconsin became a community property state. Property acquired by spouses is classified as either marital property or individual property. Property classification is determined by two important factors: (1) when the property was acquired, and (2) what funds were used to acquire it. Classification of the property determines ownership rights, not the title. Importantly, all property is presumed to be marital property, unless it can be proved otherwise. Each spouse has an undivided one-half interest in each item of marital property. Individual property generally consists of property acquired before marriage, or by gift or inheritance during the marriage. By Will or Trust, a spouse may only dispose of one-half of the marital property and all of his or her individual property.

A married couple can own property as Survivorship Marital Property. Upon the death of a spouse, this type of ownership results in the transfer of the asset directly to the surviving spouse with the use of a transfer form (HT-110) filed with the Register of Deeds office. There is no need to transfer ownership of the property through probate administration. In fact, the asset is not included as a probate asset. Another advantage of titling the property as Survivorship Marital Property is the fact that the tax basis of the property is "stepped up" to the value at the time of death of the first spouse. This can save the surviving spouse capital gain tax when the property is sold in the future. The tax is applied to the difference between the selling price and its stepped-up value, which is typically less than the difference between the selling price and its original value.

Although outside the scope of this outline, in some instances, the property may also be mixed property or unclassified. Special classification rules apply to life insurance policies and deferred employment benefits. All property can be reclassified between spouses by formal methods such as marital property agreements, gifts from one spouse to another, or by court order. Property can also be reclassified by other informal methods such as mixing marital property with individual property or by active appreciation through substantial efforts by a spouse. Note that Wisconsin's Marital Property Act is not the divorce law, it is independent of any provisions in Wisconsin law regarding property division at divorce.

III. COMMON ESTATE PLANNING TOOLS

A. Wills. Wills can be important for a variety of reasons, such as the following:

1. **Avoid the rules of intestacy.** You can decide who gets your probate property and how, thereby avoiding the application of the statutory default rules (discussed above).

2. **Utilize a testamentary trust.**

For children. Many people set up a testamentary trust for their children. The main reason for this arises out of a concern that parents don't want their children to receive their inheritance too early. For example, many people with children carry a significant amount of life insurance. Prior to developing an estate plan, most people have named their spouse as the primary beneficiary and their children as contingent beneficiaries. However, if both parents die, this means the life insurance proceeds (and all other assets) go directly to the children. In general, if they are under 18, they go into a guardianship account and the children receive the assets at 18. Because of the great disincentive this can create to finish school or pursue a career, and because of the greater risk that the assets will be poorly managed or wasted, nearly all of our clients with young children change this result by setting up a trust for their children and naming the trust as the beneficiary of their probate and most non-probate assets, such as life insurance. The trustee distributes income and principal to or for your children's benefit according to the instructions you leave in your trust (such as for health, support, education, etc.). Then, at an age that you decide, the trust typically terminates and distributes the remaining assets to your children.

Whether your children are from your marriage or from a prior relationship, if you leave all of your assets to your spouse, you run the risk that your spouse may change his or her estate plan in such a way that disinherits your children at the survivor's death. Typically, this is more of a risk for married clients with blended families, i.e., one or both spouses have children from a prior relationship. There are many ways to plan around this. For example, you can leave all or part of your assets in trust for your spouse for his or her life during which time the spouse can get income and principal from the trust. The trust usually provides that at the surviving spouse's passing, the remaining assets are left to your children or among a group of beneficiaries from which the surviving spouse can choose. When disinheritance is a concern, estate planning can get a bit complicated and time-consuming and, therefore, more expensive. In some cases, such planning may warrant separate legal representation, which can further increase cost and planning time.

Supplemental trust for a disabled child or heir. Many people set up supplemental trusts for disabled children or heirs who are receiving state or federal benefits, such as SSI. An outright inheritance often disqualifies the beneficiary for government benefits. Such trusts can be very useful in supplementing the beneficiary's lifestyle while minimizing the risk that government benefits will be lost.

Other reasons. There are a myriad of other reasons you may want to set up a trust in your will. You may want to set up a type of charitable trust, trust to hold the stock of a family business, a trust for grandchildren, etc.

3. **Nominate a guardian for your children.** The will is the only document in which you can tell the court who you want to raise your minor (under 18) children if there is no surviving parent. This person is known as a "guardian."

4. **Charitable Gifts.** For those clients with charitable intent, the will can be very useful in leaving a gift to a favorite charitable organization.

5. **Reduce the chance of unintended results in the event of multiple deaths.** You can provide in your will that a beneficiary has to survive you for a certain period, such as 90 days, in order to take property under your will. Absent such a clause, an heir has to survive only 5 days after you to take under your will. This may result in unintended consequences.

6. **Appoint your personal representative.** Absent a designation in a will, you have no say in determining who will be named as your personal representative to probate your estate.

7. **Disadvantage of Wills.** it is important to consider that a Will does NOT avoid probate. Rather the Will defines and controls the beneficiary of probate assets subject to the supervision and control of the probate process.

B. Revocable Living Trust.

With a properly funded Revocable Living Trust as your main estate planning document, you can secure <u>all of the same benefits discussed above for use of a Will</u> **AND** avoid probate.

1. What is a Revocable Living Trust? As mentioned earlier, this is a trust you create while alive that is outside of your will (that is, it is a separate document). The trust document is typically drafted to provide that you are the settlor, the trustee, and the beneficiary of the trust. After the trust is created, it is typically funded. "Funding" the trust may involve ownership changes to change the title of assets from your name as an individual to your name as trustee of your trust. For other assets, in particular, life insurance and retirement accounts, you may make beneficiary changes to properly distribute those assets according to the terms of the trust upon your death.

If you are a married, Wisconsin resident, the trust is typically a joint trust where you and your spouse are both the settlors, trustees, and beneficiaries. Whether you are married or not, the trust typically allows you to continue using your property the same way as you did before you funded the trust. Normally, there is no loss of control. For most clients, once the trust is funded, they don't even know it is there. Further, there are very few tax ramifications in most cases. For most clients, the trust will be disregarded as a taxable entity by the I.R.S. and the state.

Upon the settlor's death, there are many ways to structure the plan of disposition. If you are married, the trust typically continues as an ongoing revocable living trust for the surviving spouse, where the survivor continues as the trustee and beneficiary. However, many other options are available. For example, a credit shelter trust can be set up to minimize estate taxes or a trust can be created to preserve assets for the first spouse's children. Upon the death of the surviving spouse or upon the settlor's death if unmarried, the assets are left to children or other heirs or beneficiaries either outright or in trust.

As the name suggests, this type of trust may be amended and revoked at any time during your life, with a few conditions. First, you must be competent to make a change. Second, for married couples with joint trusts, amendments often require the consent of both spouses.

2. Some Advantages of Revocable Living Trusts.

a. **Avoid probate in Wisconsin and elsewhere.** Perhaps the main reason people set up living trusts is to avoid probate. Probate only occurs if you die with probate property in your estate. Probate property does not include contractual assets (those assets whose disposition at the owner's death is controlled by a beneficiary designation – life insurance, annuities, etc., where the beneficiary is not your estate). A revocable living trust is a contractual asset. Even if all of a married couple's assets are held in joint ownership, thereby avoiding probate at the death of the first spouse, probate would be required at the death of the surviving spouse.

Probate takes several months, and expenses are incurred for additional attorney fees, court costs, and publication of creditor notices. In the event of a family dispute, the costs may skyrocket as is typical with contested litigation. If a trust is utilized and is properly funded, probate proceedings will either be avoided entirely or will be reduced to an inexpensive formality. Even where no cost savings are realized, trusts can assure that assets are quickly distributed to family members after their deaths.

But, to avoid probate, you must transfer your probate property into the trust (including assets located in other states). Typically, a fully funded trust will completely avoid the time and cost of probate. While certain things still must be done, such as final tax returns, a fully funded living trust can take a large burden off family members and greatly reduce the amount of time and expense it takes to distribute assets to beneficiaries.

b. Centralized management. The living trust can create a centralized vehicle for managing your assets in the event you become disabled, incompetent or incapacitated. In such an event, your spouse, if you are married, or another named successor trustee, can take over the management of the trust. A Revocable Living Trust can also be an important planning tool to assure benefits for children from a prior marriage and protect children in the event of remarriage by surviving spouse.

c. Privacy. Living trusts are private. Since there are no public probate proceedings, the settlor's financial and family affairs are never made public. Wills and other probate documents, on the other hand, are subject to open records and held at the courthouse. For a fully funded living trust, the court generally never gets involved. The trustee simply writes the checks, signs the conveyances, and distributes the assets as directed in the trust.

3. Funding Revocable Living Trusts.

As previously mentioned, a major purpose of transferring probate assets into your Trust is to avoid or minimize probate in the event of your death. To avoid probate, you must fund the trust. This means you have to change title ownership of your assets to that of your trust or make sure that you have the proper beneficiary designations in place. Importantly, the sale rules apply for all future financial accounts and titled assets since you have to remember to transfer those to your trust as well.

Generally, to transfer assets to your trust, you may need to execute new documents of title, deeds to real property, and signature cards or "payable on death designations" for your bank accounts, as well as change of beneficiary forms for 401ks, individual retirement plans, and life insurance.

Because your dispositive document is the Revocable Trust, your Will becomes relatively simple, but still necessary. While certainly it is preferrable for all probate assets transferred to the Trust, in the unlikely event that one or more assets remain outside the Trust at the time of your death, there needs to be a vehicle to probate the asset and transfer it to the Trust. Thus, we still need a short-form Last Will and Testament to cover this possibility- referred to as a "pour-over will." As the name indicates, in the event there are assets outside of the Trust at the time of your death that need to be probated, those are poured over into the Trust to be distributed according to the terms and conditions of the Trust itself.

Also, for married couples, a marital property agreement (MPA) is strongly recommended. Nevertheless, these additional costs are often a small fraction of the savings provided by a fully funded trust that avoids probate.

C. Marital Property Agreements ("MPA's").

An estate planning oriented MPA does not apply (unless requested) to the division of assets in the event of divorce. Rather, its main purposes are to provide legal certainty with respect to the classification of assets at death, to help equalize estates for those clients doing estate tax planning, minimize capital gains taxes and provide for the non-probate transfer of assets to your trust. If you want to control how your property is classified during life, at death, and/or in the event of a divorce, you most likely will need an MPA. They can save a tremendous amount of time and expense in the event a classification dispute arises in the probate court or the I.R.S. Classifying assets as marital property can also provide very significant capital gains tax savings.

D. Durable Power of Attorney ("DPOA").

How will your assets be managed if you become temporarily or permanently disabled, incapacitated, or incompetent? Many people address this problem by executing a DPOA. In a DPOA you appoint one or more individuals or "agents," often a spouse, relative, or close friend, to act as your agent to manage your assets. The document can be structured to become effective immediately or only in the event of mental disability, incapacity, or incompetency. Absent this document, you often have to go through an expensive guardianship hearing (a trial in certain cases) to have a guardian appointed to manage your property. By using this document, you get to decide in advance who will be managing your property and, in most cases, avoid a guardianship hearing. Further, you can expressly control what powers you give to your agent.

E. Health Care Power of Attorney ("HCPOA").

If you become mentally incapacitated, you can no longer make your own health care decisions. With a HCPOA, you nominate an agent to make health care decisions for you in the event of such incapacity. The agent typically has broad discretion to make decisions for you. Under Wisconsin law, you have to indicate specifically if you authorize your health care agent to place you into a nursing home or community based residential facility for long term stays, whether your agent is authorized to withdraw a feeding tube and whether your agent can make health care decisions for you if you are pregnant. You can also add additional wishes or restrictions. Further, you can use this document to make anatomical gifts.

Without a HCPOA, many people have to go through a guardianship proceeding in which the court is asked to appoint a guardian to make your health care decisions for you. That individual may not be your person of choice and may be unfamiliar with your personal views regarding health treatment. Further, the procedure is time-consuming and expensive.

F. Declaration to Physicians/Living Will.

In general terms, the Living Will provides a written statement of your health care wishes regarding the use or withdrawal of health care under certain conditions. It is important to note that the HCPOA provides much more discretion to your health care agent and therefore is much more flexible than the Living Will which typically directs physicians to do "this" or "that" under certain conditions.

IV. COMMON ESTATE PLANS

It's impossible to describe all the different types of estate plans because of everyone's unique circumstances. However, we have found the following types of plans tend to be the most common. The details within each plan can vary greatly depending on your needs and goals.

A. "Essentials Plan"

1. **Will** (with trust for children and guardianship provisions if applicable).
2. **Durable Power of Attorney.**
3. **Power of Attorney for Health Care** and **Living Will**

B. " Foundation Plan"

1. **Revocable Living Trust (joint for married couples).** For married couples, this typically contains an ongoing revocable living trust for the surviving spouse. Often a subtrust is included for children and/or grandchildren at the surviving spouse's death.
2. **Pour-Over Wills.** These are used to distribute probate assets to the trust if all such assets were not transferred into the trust.
3. **Durable Power of Attorney.**
4. **Health Care Power of Attorney** and **Living Will**.
5. **Marital Property Agreement.**
6. **Trust Funding Documents.** To transfer assets into the trust, including deeds and various assignments.

C. "Legacy Plan"

1. **Revocable Living Trust (joint for married couples).** For married couples, this typically contains a credit shelter trust and on ongoing survivor's trust (which is simply an ongoing revocable living trust for the surviving spouse). Often a subtrust is included for children and/or grandchildren at the surviving spouse's death.
2. **Pour-Over Wills.**
3. **Durable Power of Attorney**
4. **Health Care Power of Attorney** and **Living Will**.
5. **Marital Property Agreement.**
6. **Trust Funding Documents.**

V. WHAT TO CONSIDER BEFORE YOU MEET WITH AN ATTORNEY TO DISCUSS YOUR ESTATE PLAN?

A. A complete list of your assets, including how you have titled the assets and beneficiary designations. The attorney will want to make sure that the titling of your assets is clear and is according to your wishes.

B. It is important to review all of your beneficiary designations to make sure they “fit” and “aligned” with your entire estate plan and provide advice regarding the proper language. How you make your beneficiary designations can also impact income tax planning and creditor claims.

C. The names of the people who you wish to appoint to handle the various roles in your estate plan, such as who you want to be your personal representative or successor trustee, your financial agent, and your health care agent. If you plan to leave any assets to minor children, you’ll also want to name a trustee for the children’s Trust.

   It is extremely helpful to name a primary person for each role, plus one or two alternates.

D. A list of concerns that you want to discuss. If your family situation involves complex matters such as planning for a disabled family member, creating a trust for a family member with an addiction or serious financial problems, or a plan to disinherit someone, be sure to raise those issues during your initial meeting with your attorney. Addressing those types of issues can have an effect on many aspects of your plan and would be difficult to address after your plan is selected and the drafting work has commenced.

E. If there are younger beneficiaries, you may want to delay outright distributions and create a trust for their benefit instead. During the time the beneficiary is “growing up”, your Trustee can use their funds for their health, education, maintenance, and support . This allows for the money to be used if the Trustee decides it is necessary while it keeps a young beneficiary from having unlimited access to money before they mature. Most people want beneficiaries to reach at least 25 years old before receiving full control of their assets. Some opt for older, some younger.

   It is also common to want assets given to beneficiaries in more than one chunk. For example, they could receive 1/3rd when they turn 25, then 2/3rd of the remainder when they turn 30, then the rest at 35. This may give the beneficiary a chance to learn some life lessons at the first distribution, and they may not make the same mistakes at their next distribution.

Another option is to create a beneficiary protection trust for your beneficiaries. This is a trust that will completely asset protect any inheritance from the beneficiaries creditors, lawsuits and divorces. All of the same distribution schemes can be implemented and your beneficiary can be their own trustee (if appropriate), with all the asset protection benefits.

F. We hope this never happens to you, but we need to consider who should inherit from you if you pass away die and your spouse dies (if married), and you have no living beneficiaries. If you are a parent, this means that all your descendants have also died. For people with many children or grandchildren, this possibility is very remote, but for some with only one child or none, it can be more likely.

In any case, we need to provide for the what if you die, and you have no living descendants, and all identifiable beneficiaries are also gone. Here are some common choices:

If you are married, your closest relative(s) by law will receive 50%, and your spouse's closest relative(s) by law will receive 50%. If you are not married, your closest relative(s) by law will receive everything.

A portion (or all) will go to charities.

A portion (or all) will go to specific people or groups of people.