

# Estate Planning

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## What is Estate Planning?

Estate planning is the process of analyzing assets, establishing goals and devising a plan for managing your wealth during life, and for minimizing taxes and distributing wealth upon your death.

## Why is Estate Planning Important?

**Guardianship of Minor Children.** Who will raise your children if you and your spouse predecease them? Even people with very modest estates or those with no probate estates still need a will in order to name a guardian for their minor children. Your children's guardian does not have to be the same person you name to manage your children's inheritance. In addition, you can provide suggestions, guidance and directives as to how you want your children raised and as to what are acceptable expenditures for them.

**Disposition of Property.** Whom do you want to inherit your property? This decision can be complicated especially if you have children from a prior marriage or if your children have different needs from one another.

**Adequacy/Liquidity of Estate.** Do you have sufficient assets to provide for your family on your death and, even if so, do you have adequate *available cash assets* needed to pay for estate taxes, expenses of administration, and for family needs without forcing the sale of non-cash assets at a disadvantageous time? Life insurance may be one way to ensure those needs are met.

**Asset Management.** Who will manage your assets if you become incompetent? Who will manage your estate upon your death? Who

will manage funds left to your minor children? Who will handle the financial affairs of a special needs child?

**Business or Farm Continuity.** Are you concerned about the succession of ownership and control of your family business or farm? A Buy-Sell Agreement with life insurance to fund the agreement might be an important part of your estate plan. A Family Limited Partnership is also a tool you might use to assure continuity and control and as a way to preserve the value of your business while passing it on to your family.

**Tax Savings.** Death taxes can take a significant bite out of inadequately planned estates. This year the exemption from federal estate taxes is \$2 million and there is no Wisconsin estate tax. Next year the federal exemption increases to \$3.5 million and, supposedly, there will be no estate tax at all in 2010. However, current law provides that in 2011, the exemption drops back to only \$1 million, and both the federal and Wisconsin tax exemptions are subject to change. So, if you and your spouse's combined estate exceeds \$1 million (and you do not plan to die before 2011), there are many estate planning measures you can take to minimize or even possibly eliminate death taxes.

### **What are Estate Taxes?**

Generally, a person receiving an inheritance from you does not pay an "inheritance tax." Rather, our system now taxes your assets before they are passed on. Your "estate" pays the tax. When you die, both the state and federal governments may impose an estate tax on the assets that you have accumulated during your lifetime. Many people refer to this as a "death tax." Not all of your assets get taxed. Up to a certain amount, your assets are safe from the tax. However, if you have assets over that exemption amount, the tax burden can be huge.

The taxes applicable to estates (federal estate tax, state estate and/or inheritance tax, generation skipping transfer tax, gift tax, fiduciary income tax) are complex, always changing and frequently avoidable. If your estate will exceed \$1 million on or after January 1, 2011, your estate will be subject to estate taxes. It is imperative that you get professional advice in preparing your estate plan.

As a very general overview, under the federal estate tax laws, you can pass an unlimited amount tax-free to your spouse under the “unlimited marital deduction” and you can pass an amount equal to your “applicable exclusion” to other beneficiaries free of the federal estate tax.

There are also exemptions and exclusions from the gift tax and generation skipping transfer taxes. The following chart sets forth the estate tax applicable exclusion, the gift tax exemption, the generation skipping transfer tax exemption and the estate and gift tax rates during the phase out years of 2002 – 2010, and the rates when the Economic Growth and Tax Relief Reconciliation Act of 2001 is repealed in 2011 (for more on the Act, see the following sections on planning for mid-size and large estates).

<b>Estate, Gift and GST Tax Exemption Amounts And Highest Estate, Gift and GST Tax Rates</b>					
<b>Year</b>	<b>Estate Tax Exemption Amount</b>	<b>Highest Estate and GST Tax Rate</b>	<b>Gift Tax Exemption Amount</b>	<b>Highest Gift Tax Rate</b>	<b>GST Exemption Amount</b>
2002	\$1,000,000	50%	\$1,000,000	50%	\$1,000,000
2003	\$1,000,000	49%	\$1,000,000	49%	\$1,000,000
2004	\$1,500,000	48%	\$1,000,000	48%	\$1,500,000
2005	\$1,500,000	47%	\$1,000,000	47%	\$1,500,000
2006	\$2,000,000	46%	\$1,000,000	46%	\$2,000,000
2007	\$2,000,000	45%	\$1,000,000	45%	\$2,000,000
2008	\$2,000,000	45%	\$1,000,000	45%	\$2,000,000
2009	\$3,500,000	45%	\$1,000,000	45%	\$3,500,000
2010 <sup>1</sup>	Repeal	None	\$1,000,000	35%	Repeal
2011 <sup>1</sup>	\$1,000,000	55%	\$1,000,000	55%	\$1,000,000

<sup>1</sup> The numbers shown for 2010 and 2011 in this chart assume that the repeal and sunset provisions under the Act will take effect without change. There is, however, a significant likelihood of additional tax legislation before then.

In addition to the lifetime gift tax exemption shown in the above table, you are allowed a \$12,000 per recipient annual gift tax exclusion. Married couples can gift \$24,000 per recipient per year.

### **How Large of a Bite can Estate Taxes Take?**

Failure to properly plan can result in a substantial reduction in the size of your estate available for you to pass to your beneficiaries. The following estates of some very famous people could likely have saved significant amounts with proper planning. While most of us have significantly smaller estates, the bite of the estate tax can still be severe.

<b>Estates of Famous Persons</b>				
<b>Name</b>	<b>Gross Estate</b>	<b>Total Settlement Costs</b>	<b>Net Estate</b>	<b>Percent Shrinkage</b>
W.C. Fields	884,680	329,793	554,887	37%
Dixie Crosby	1,332,571	781,953	550,618	59%
Franklin D. Roosevelt	1,940,999	574,867	1,366,132	30%
Humphrey Bogart	910,146	274,234	635,912	30%
Clark Gable	2,806,526	1,101,038	1,705,488	30%
Henry J. Kaiser, Sr.	5,597,772	2,488,364	3,109,408	44%
Al Jolson	4,385,143	1,349,066	3,036,077	31%
Gary Cooper	4,984,143	1,349,066	3,036,077	31%
Myford Irvine	13,445,552	6,012,685	7,432,867	45%
Walt Disney	23,004,851	6,811,943	16,192,908	30%
William E. Boeing	22,386,158	10,589,748	11,796,410	47%
Hedda Hopper	472,661	165,982	306,679	35%
Marilyn Monroe	819,176	448,750	370,426	55%
Erle Stanley Gardner	1,795,092	636,705	1,158,387	35%
Cecil B. DeMille	4,043,607	1,396,064	2,647,543	35%
Elvis Presley	10,165,434	7,374,635	2,790,799	73%
J.P. Morgan	17,121,482	11,893,691	5,227,791	69%
John Rockefeller, Sr.	26,905,182	17,124,988	9,780,194	64%

Alwin C. Ernst, CPA	12,642,431	7,124,112	5,518,319	56%
Frederick Vanderbilt	76,838,530	42,846,112	33,992,418	56%
Howard Gould	67,535,386	52,549,682	14,985,704	78%

## **What Happens if You Don't Have an Estate Plan or a Will?**

### **Laws of Intestacy**

If you have no will, the court will distribute your assets according to the law of intestacy. Intestacy laws essentially provide a default will for people who die without wills. Under Wisconsin intestacy law, your property will pass to your surviving spouse if either (1) you leave no children, or (2) all of your children are also children of your spouse. Under intestacy, if you leave children that are not the children of your spouse, one-half of your individual property will go to those children. Minor children take control of their shares at age 18 regardless of their ability to manage funds.

### **What is Probate?**

Probate is the court-supervised process of validating wills, ensuring that creditors and taxes are paid, and distributing assets to the rightful heirs.

### **Do All of Your Assets Have to Pass Through Probate?**

No. With proper planning, you can pass many of your assets to your heirs completely outside of the probate process. As a result, your probate estate may be much smaller than your taxable estate. You may, in fact, have no probate estate whatsoever.

Probate assets are only those assets that pass under the terms of your will or under the laws of intestacy, should you die without a will.

Examples of some non-probate assets are those of your assets that:

- Pass by beneficiary designation, such as life insurance proceeds;

- Pass by contract, such as under a buy-sell agreement;
- Pass by operation of law, such as property held in joint tenancy with rights of survivorship; and
- Assets you transfer during your lifetime to a “Living Trust” that sets out terms for management and ultimate distribution of trust assets.

There is often confusion between taxable estate assets and probate assets, but the distinction can be extremely important. Assets that will be included in your estate for death tax purposes include many assets you may not think of when considering your personal net worth, such as the proceeds of life insurance policies, amounts payable under pension, profit-sharing and other retirement plans, deferred income, and interests in trusts created by others. It is, therefore, essential that you coordinate the beneficiary designations of your non-probate assets with your overall estate plan.

### **Are There Disadvantages to Probate?**

- Probate costs to your estate can be significant.
- The probate process can result in substantial delays in transferring your assets and closing your estate.
- Probate results in a loss of privacy because the size and details of your estate in probate are matters of public record.

# **TYPICAL ESTATE PLANNING DOCUMENTS FOR ALL PEOPLE - REGARDLESS OF THE SIZE OF YOUR ESTATE**

## **1. Last Will and Testament (Will)**

A will is an integral part of every estate plan, but it is important to remember that a will only governs your probate assets and will not determine who receives property that passes by beneficiary designation, contract, or operation of law. Even estate plans designed to avoid probate by using living trusts should also include a will in order to pass any property that has not, for whatever reason, been transferred to the trust during lifetime.

### **Advantages of a Will:**

- **Avoids distribution under the laws of intestacy**

Most people would prefer to choose who would receive their property when they die rather than leave that decision to the State under the laws of intestacy.

- **Nominates a guardian for minor children**

The Court almost always appoints relatives as guardian, but relatives are not always the best choice and consideration must be given to the financial situation of the potential guardian as well as his or her health, age, willingness and ability to care for your children.

- **Waives the probate bond**

Unless directed otherwise by a will, the Court will require a fiduciary bond to be posted by your personal representative, and this cost will be borne by your estate.

- **Names your Personal Representative**

Because the duties and responsibilities of administering your estate can be time consuming and complicated, a qualified individual and/or corporate trust company should be chosen.

- **Permits specific bequests to individuals**

Specific bequests of jewelry, heirlooms, cash, or other property may be made in a will. If you do not have a will, your property will simply be distributed pursuant to the intestacy laws.

- **Can expand the powers of your personal representative and can reduce liability of your personal representative**

Under a will, you can expressly permit your personal representative to take certain actions that would not otherwise be allowed absent the cost and delay of court approval, and you can reduce or eliminate the potential liability for taking such actions.

- **Tax Savings**

Substantial tax savings are possible through the use of testamentary trusts established in your will.

- **Peace of mind**

Although not measurable in dollars, peace of mind is a valuable benefit for anyone concerned with his or her family's well being.

## **2. Powers of Attorney**

Powers of Attorney for financial and health care purposes name the person who may make decisions for you in the event you are incapacitated. These estate-planning documents help avoid delays in asset management as well as help to avoid the cost and potential embarrassment of court proceedings.

## **3. Living Wills**

A Living Will sets forth the type and extent of life support measures you wish to be taken in the event you cannot make these decisions for yourself. Living wills save your family members from having to make difficult and often painful decisions during a time of stress.

## 4. Trusts

You can create a trust during your lifetime (an “*intervivos* trust”) or as part of your will (a “*testamentary* trust”) to, for example, manage your property, manage assets for minor or incompetent beneficiaries, or provide for the needs of a second spouse during his/her lifetime with assets passing to the children of your first marriage upon your second spouse’s death. A very popular kind of trust that many people use is a Living Revocable Trust.

### **Living Revocable Trusts**

A Living Trust (also known as a revocable trust) is a trust you create during your lifetime to manage your property during your lifetime and to pass your property to your beneficiaries upon your death *without formal probate proceedings*.

A Living Trust does not, in and of itself, save taxes, but it can be drafted in a manner that minimizes taxes (as can a will). An example illustrating how a joint revocable trust works is included near the end of this booklet.

### **Advantages of Living Trusts**

- **You Retain Ownership and Control**

You, as your own trustee, continue to own and control your assets for as long as you are living and competent.

- **Revocable**

A Living Trust is easily amended or terminated.

- **Smooth Transition**

A successor trustee that you name in your trust steps in to take over as trustee upon your death or incapacity without the need for court intervention or potential publicity.

- **Avoids Probate**

Assets transferred to your revocable trust during your lifetime will pass free of probate. This is especially beneficial if you own out-of-state real estate, in which case your estate would have to go through a probate proceeding in that state as well as in your state of residency. Any assets you fail to transfer to the trust during your lifetime will be probate assets and will pass according to the terms of your will.

- **Avoids Court Accountings**

Annual court accountings along with accompanying legal fees are not required for living or revocable trusts, but are required for testamentary trusts.

## **5. Marital Property Agreements**

A Marital Property Agreement classifies property as marital or individual and should be a part of most estate plans for married couples (especially in second marriage situations where there are children from the first marriage).

Wisconsin is one of only a few “community property” states. This means that, by default, one-half of all marital assets belongs to each spouse – regardless of how individual assets are titled and regardless of who brought what into the marriage. Many people are quite satisfied with this rule, while others would prefer to hold certain assets as their individual property. You should discuss this issue with your attorney as a part of your estate planning.

## **ESTATE PLANNING FOR A MID-SIZE ESTATE (\$1 - \$5 MILLION)**

Today, we are in a period of legal flux with regard to death tax planning, which makes planning for mid-size estates especially difficult. The current estate tax law expires in 2010 and, if

Congress does not pass a new one, in 2011 the law will revert to what it was in 2001. The exclusion amount may go up, or it may go down. You are taking a big risk by not planning as if your estate will be subject to the tax.

Individuals with small estates can disregard death tax planning and focus on the more personal aspects of estate planning; taxes aside, there still remain many other reasons for carefully crafting an estate plan. Individuals with large estates must continue to employ the myriad tax planning vehicles. But, planning for a mid-size estate involves a significant degree of uncertainty because of the uncertainty of the changing tax laws.

The following tables show the impact of the changing laws on estates of \$2,000,000 and \$5,000,000. The examples assume that both spouses die in the same year and that their estate plan consists of a Family Trust with a total value equal to the then estate tax exemption and a bequest upon the first death to the surviving spouse of the remainder of the estate. Using the exemption amount and the marital deduction, there would be no estate tax due until the death of the surviving spouse. However, because the exemption amount continues to increase, it could have the unintended result of disinheriting the surviving spouse.

<b>\$2,000,000 ESTATE</b>			
<b>Year</b>	<b>Family Trust</b>	<b>Marital Gift</b>	<b>Estate Tax at Death of Surviving Spouse</b>
2001	\$675,000	\$1,325,000	\$260,000
2002	\$1,000,000	\$1,000,000	-0-
2004	\$1,500,000	\$500,000	-0-
2006-2010	\$2,000,000	-0-	-0-
2011	\$1,000,000	\$1,000,000	-0-

<b>\$5,000,000 ESTATE</b>			
<b>Year</b>	<b>Family Trust</b>	<b>Marital Gift</b>	<b>Estate Tax at Death of Surviving Spouse</b>
2001	\$675,000	\$4,325,000	\$1,799,000
2002	\$1,000,000	\$4,000,000	\$1,430,000
2004	\$1,500,000	\$3,500,000	\$945,000
2006	\$2,000,000	\$3,000,000	\$460,000
2009	\$3,500,000	\$1,500,000	-0-
2010	\$5,000,000	-0-	-0-
2011	\$1,000,000	\$4,000,000	\$1,799,000

### **The Family/Disclaimer Trust**

In mid-size to large estates, a typical estate plan will use a formula designed to take maximum advantage of estate and generation skipping transfer tax exemptions but, as the above table illustrates, a change in the exemption can dramatically alter the results of the formula with possibly unforeseen and unintended results. Accordingly, the inability to ascertain the tax consequences without knowing the year of death makes it advisable to build flexibility into an estate plan, and the best way to accomplish this is by using a disclaimer estate plan.

A disclaimer estate plan passes everything to your surviving spouse (either outright or in a Marital Trust) and creates a Family Trust for the benefit of your surviving spouse and children that will be funded only if your spouse disclaims all or a portion of your marital bequest.

The benefit of this type of estate plan is that it permits your surviving spouse and his/her advisors to make tax-planning decisions following the first death when all of the relevant facts are known. A disclaimer estate plan flow chart is included near the end of this booklet.

### **Methods of Reducing Taxable Estate**

In addition to the above methods of taking maximum advantage of the estate tax exemption, you can reduce the size of your taxable

estate by following fairly simple methods (see section on planning for large estates for more sophisticated methods of minimizing taxable estates):

- Make tax-free lifetime gifts to your spouse to equalize your estates, or classify all property as marital property.
- Make annual tax-free gifts of up to \$12,000 (\$24,000 for a married couple) to each child, grandchild, or other individual. Such gifts can be made in trust.
- Directly pay tuition or medical expenses for your children and/or grandchildren. These payments qualify as tax-free lifetime gifts.

## **ESTATE PLANNING FOR LARGER ESTATES**

The following table reflects the estate tax payable on the death of the surviving spouse for a \$10 million estate utilizing a typical formula plan that funds a Family Trust with the maximum available estate tax exemption and gives the remainder to the surviving spouse.

<b>\$10,000,000 ESTATE</b>			
<b>Year</b>	<b>Family Trust</b>	<b>Marital Gift</b>	<b>Estate Tax at Death of Surviving Spouse</b>
2001	\$675,000	\$9,325,000	\$4,549,000
2002	\$1,000,000	\$9,000,000	\$3,930,000
2004	\$1,500,000	\$8,500,000	\$3,345,000
2006	\$2,000,000	\$8,000,000	\$2,760,000
2009	\$3,500,000	\$6,500,000	\$1,350,000
2010	\$10,000,000	-0-	-0-
2011	\$1,000,000	\$9,000,000	\$3,930,000

As the above table indicates, estate taxes can be shockingly high for large estates. However, in addition to the previously described means of reducing your taxable estate, the following are examples of other more sophisticated means appropriate for larger estates:

- Make lifetime gifts of appreciable assets up to the available estate tax exemption in order to remove future appreciation from your taxable estate.
- Create a *Generation Skipping Trust* for grandchildren and more remote issue to take advantage of the \$1 million exemption from the generation skipping transfer tax and to avoid estate tax in your children's generation.
- Make gifts of interests in a *Family Limited Partnership* to transfer assets and future appreciation to children while retaining control of your family farm or business.
- Create a *Qualified Personal Residence Trust* to hold title to a primary and/or vacation residence and remove the value of remainder interest from your taxable estate while retaining lifetime use.
- Create an *Irrevocable Life Insurance Trust* to pay your estate taxes with insurance proceeds that will not be included in your taxable estate. Refer to the chart included near the end of this booklet.
- Create a *Charitable Remainder Trust* or a *Charitable Lead Trust* to fund either lifetime or testamentary charitable bequests while obtaining present income and estate tax benefits.
- Create a *Private Foundation* to provide a charitable legacy while obtaining present income and estate tax benefits.

## **INFORMATION NECESSARY FOR PREPARATION OF YOUR ESTATE PLAN**

Prior to meeting with your attorney, consider the following issues and gather the following information:

- **Guardians for Your Minor Children**

Who would be best able to raise your children? Consider the age of proposed guardians, ages of their children, and the health and financial situation of all parties. Decide on an alternate should your first choice be unable or unwilling to serve and, if you name a couple and one of them dies, would you want the survivor to act as sole guardian? What if they divorce?

- **Personal Representative of Your Estate**

Who would you want to handle the details of paying your debts and death taxes and distributing your assets? This responsibility takes time and requires attention to detail.

- **Living Revocable Trust**

Is it important to you to avoid probate or to be prepared in the event of incapacity? Almost everyone should consider the use of a revocable trust. Do you want to create a trust that will provide for your spouse and/or children rather than give them direct control of assets you leave them?

- **Trust and Trustee**

If you have decided to create a trust, you will need to name a trustee to manage investments, pay taxes, make distributions, etc., and you will want to provide for one or more successor trustees. Who might you want to do this job? Remember, you can always name an institutional trustee, like a bank or trust company; however, this can be an expensive option.

- **Corporate vs. Individual Trustees**

Personal representatives and trustees can be either individuals or corporate trust companies (banks). Corporate fiduciaries have the advantages of permanence, financial accountability, impartiality, investment expertise, tax and accounting abilities, and studies have shown that they sometimes save many dollars in the average estate. An individual, on the other hand, may not charge a fee, may have a more personal interest, may be more

flexible, and may have special expertise such as running the family business. You could name an individual and a corporate trustee as co-trustees in order to obtain the advantages of each.

- **Distributions to Children**

If you do not want your assets distributed outright to your children, you should provide for your assets to be held in a trust until your children reach the age or ages you specify. Many people prefer to distribute their estate assets over time, such as when their children reach ages 25, 30 and 35. This way, the children get used to handling large sums of money without putting everything at risk. You should also consider whether you would like the trustee to have the discretion to make early distributions for specified purposes such as education or down payments on a home or business.

- **Charitable Bequests**

Are you interested in making any charitable bequests? Your attorney can provide you with more information on how to do this in a manner that reduces both income and death taxes.

## **ESTATE PLANNING QUESTIONNAIRE**

The more information you can provide to your estate planning attorney, the better prepared your attorney will be in advising you. This means that your plan will be more likely to achieve your goals and it also makes the estate planning process less expensive. It is important to keep this information up-to-date; you should review your estate plan at least every three years and immediately review the plan whenever there are changes in your family structure (birth, death, marriage, divorce, etc.). Filling out an estate planning questionnaire provides a good start in the estate planning process.

### *Disclaimer*

*This outline is general in nature, is subject to changes in laws and regulations, and should not be relied upon as legal or tax advice. You should consult your own professional advisor before taking any action that relates to the subject matter of this outline.*