# Planning Essentials for Small and Modest Estates

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## Introduction

For the vast majority of attorneys, the net worth of most of our clients falls far below an amount that would require gift, estate or generation-skipping transfer tax planning. In this seminar, we will explore the basics of planning for small and modest estates, including essential estate planning documents everyone should have in place. We will also explore the differences when planning with a will and when planning with a revocable living trust. Finally, we will explore how and when to effectively use direct beneficiary designations for various types of assets to avoid probate.

## Essential Estate Planning Documents

Regardless of your age or financial circumstances, *everyone* needs an estate plan. For the benefit of your loved ones, you should have at least the following basic estate planning documents in place:

### Will (or Living Trust)

Your will sets forth the disposition of your estate upon your death and can include the creation of testamentary trusts upon your death for young beneficiaries or for beneficiaries with other special circumstances. In addition, your will designates the personal representative (a/k/a "executor") of your estate and states your preference as to the guardians for your minor children, if any. It is important to note that, if you are depending on your *will* to transfer your assets, a probate proceeding will be required to administer your estate upon your death. As an alternative, you may want to consider creating a revocable living trust.

### Property Power of Attorney

Your property power of attorney (a/k/a "financial power of attorney" or "durable power of attorney") authorizes your agent to manage your financial affairs. Your property power of attorney can become effective either immediately or only in the event you are unable to manage your financial affairs yourself. A comprehensive property power of attorney can avoid the need for a guardianship proceeding (a/k/a "living probate") in which the court appoints a legal guardian of your *estate* during any period of mental incapacity.

Health Care Power of Attorney

Your health care power of attorney authorizes your designated agent to make medical decisions for you when you cannot. A comprehensive health care power of attorney can avoid the need for a guardianship proceeding (a/k/a "living probate") in which the court appoints a legal guardian of your *person* during any period of mental incapacity.

Living Will

Your living will (a/k/a "directive to physicians") states your care wishes about life-support machines or feeding tubes if you become terminally ill or you lapse into a persistent vegetative state (permanent coma).

HIPAA Authorization

Your HIPAA authorization (a/k/a authorization for release of protected health information) authorizes the release of your health information to designated persons.

Authorization for Final Disposition and Memorial Instructions

Your Authorization for Final Disposition authorizes a designated individual to make funeral arrangements on your behalf and should also include a statement of your personal wishes as to burial or cremation services.

Personal Property Memorandum

Your personal property memorandum provides instructions directing the disposition of your personal effects such as jewelry, family heirlooms and special collections. Instructions regarding digital property can also be included in a memorandum. *In order for this type of memorandum to be legally enforceable, your will must contain language specifically referencing the document. See Wis. Stat. § 853.32.*

Maintaining the Estate Plan

To ensure the estate plan remains consistent with your client's estate planning goals, you should:

1) Review estate planning documents on a regular basis (at least every few years and also whenever there is a change in circumstance).

2) Review the titles and beneficiary designations for all assets.

3) Make sure your client's loved ones know where to locate the original estate planning documents, information regarding your client's assets and other important information and documentation.

## Primary Types of Ownership

Sole Ownership

Sole ownership ("fee simple" interest) occurs when an asset is titled solely in one individual's name. The asset becomes part of the owner's probate estate upon his or her death.

Tenancy in Common

Tenancy in common occurs when title to an asset is held in the name of two or more individuals as "tenants in common". In Wisconsin, tenancy in common is the default ownership characterization when the instrument of title is silent on the issue and when property is held jointly between non-married individuals (*see Wis. Stat. § 700.20*). When property is held as tenants in common, each tenant owns his or her share of the property and has no rights in the interests of other owners; interests can be owned in different percentages. Any owner can transfer his or her interest without the consent of the other owner(s). Upon transfer, the new owner becomes a tenant in common with the other existing owner(s). The owner's interest becomes part of his or her probate estate upon his or her death.

Joint Tenancy

Joint tenancy with rights of survivorship (JTWROS) occurs when title to an asset is held in the name of two or more individuals as "joint tenants". In Wisconsin, with regard to a homestead, survivorship marital property is the default ownership characterization when the instrument of title is silent and when property is held solely between husband and wife (*see Wis. Stat. § 766.605*). When property is held as joint tenants, each tenant has an undivided right to the enjoyment of the property. When a joint tenant dies, that owner's interest transfers outside of probate to the remaining joint owners. However, while a joint tenant is alive, he or she can transfer his or her interest to another person. Upon transfer, the new owner becomes a tenant in common with the other existing owner(s).

Trust Ownership

Trust ownership: Property titled in the name of a trust is governed under the terms of the trust instrument and generally transfers to the designated beneficiaries outside of probate.

## Wills

Legal Requirements/Testator Capacity

A will must be in writing and must be signed by the testator (sometimes referred to as the "testatrix" when female), or by someone else in the testator's name in his or her conscious presence and at his or her direction, in the presence of two disinterested witnesses who must also sign the will (*see Wis. Stat. § 853.03*). Some states, including Wisconsin, allow the inclusion of a notarized self-proving affidavit to avoid the necessity of witness testimony before the will can be admitted to probate (*see Wis. Stat. § 853.04*).

The testator must be at least 18 years of age and of sound mind (*see Wis. Stat. § 853.01*). The requirements for testamentary capacity ("sound mind") are relatively minimal, generally requiring that the testator is aware of the following: The extent and value of his or her property, the persons who are the testator's natural beneficiaries, how the property will be distributed under the terms of the will, and how these elements relate to form an orderly plan for distribution of the testator's property.

<u>Revocation</u>

Revocation of a will can generally be accomplished by destroying the old will with intent to revoke it (i.e., burning, tearing, shredding), by creating a new will with language stating the testator's desire to revoke all prior will, or by amending an existing will by codicil thereby creating a newly amended will (*see Wis. Stat. § 853.11*).

<u>Essential Provisions</u>

Appointment of a personal representative (also known as an "executor") to administer the estate. Successor personal representatives should be named in the event the primary personal representative is unable or unwilling to act. The will should also define the personal representative's powers and duties.

Guardians for minor children. Successors should also be named in the event the primary guardian is unable or unwilling to act. Note that naming a guardian in the will is actually a *nomination* rather than appointment, which must come from the court.

Final distribution of the estate, which can include both specific distributions of estate assets and the distribution of everything else (known as the "residue" of the estate). Alternate beneficiaries should also be named in the event a primary beneficiary predeceases the testator. Note that a will can create a *testamentary trust* to avoid an outright distribution to a beneficiary. For example, it might be advisable to hold assets in trust for a young beneficiary, for a beneficiary with special needs, or for a beneficiary with creditor issues. If a testamentary trust is created, then the will should also name the trustee of such testamentary trust. The creation of a testamentary trust will <u>not</u> avoid a probate proceeding upon the death of the testator. However, note that under Wis. Stat. § 853.34(3), if a trustee of a trust created by a testator's will is designated as the beneficiary of a transfer under another governing instrument, at the death of the testator or at the death of a third party, the transfer of any assets under that other governing instrument to the trustee does not cause the transferred assets to be included in the property administered as part of the testator's estate. The transferred assets are not subject to taxes, debts, or charges enforceable against the testator's estate to any greater extent than if the proceeds were payable to a beneficiary other than the testator's estate.

## Revocable Living Trusts

A revocable living trust (also known as an "inter vivos" trust) is an estate planning tool used primarily to establish who will manage your assets during your incapacity and how your property will be distributed upon your death. Most living trusts are "revocable" because you retain the power to amend them as your circumstances or wishes change. Revocable living trusts are "living" because they are created and become effective during your lifetime.

Generally, one of the primary purposes of creating a revocable living trust is to avoid the necessity of a probate proceeding upon your death. Upon your death, any asset titled solely in your name, with no direct beneficiary designation, is typically subject to the probate process[1] – *even if you have a valid will in place*. Probate is the court-supervised process of validating your will, if you have one, of ensuring your final debts and expenses are paid and then distributing the remaining probate estate to the beneficiaries name in your will or to your heirs at law if you have no valid will in place (i.e., you died "intestate"). Probate can be expensive and time consuming, and is generally a *public* court proceeding. If you own real estate in multiple states, a separate probate proceeding in each state in which you hold property at the time of your death is often necessary. Property owned by your revocable living at the time of your death will pass according to the terms of your trust, *without the necessity of a probate proceeding*.

The three primary positions of a trust are:

1) The grantor (also known as a "trustor" or "trustmaker"), who creates the trust and transfers his or her assets into the trust (can be a single grantor or joint grantors);

2) The trustee, who manages the assets owned by the trust (can be a single trustee or joint trustees); and

3) The beneficiaries: The lifetime beneficiaries receive the benefit of the assets in the trust during the grantor's lifetime (generally this is the grantor himself or herself, along with anyone who is dependent upon the grantor) and the death beneficiaries receive the assets in the trust upon the grantor's death.

A revocable living trust agreement is a written document, signed by the grantor(s), typically in the presence of two witnesses and a notary public (note that legal requirements of a validly executed trust document vary from state to state). The agreement should name an initial trustee and successor trustees in the event the grantor becomes incapacitated and upon the grantor's death. The agreement should also specify how the property in the trust will be distributed upon the grantor's death. Beneficiaries can include individuals and/or charities, and can specify *how* each beneficiary's share is to be distributed. For example, the trust language can create separate trusts to protect minors, young adults, beneficiaries with special needs and financially irresponsible beneficiaries. With proper drafting, the trust can provide its beneficiaries with both divorce and creditor protection (note that the laws regarding these types of trusts vary from state to state). For example, Wis. Stat. § 701.0502(4) provides that real property or tangible personal property that is owned by a trust and used by, but not distributed to, a beneficiary may not be reached by a creditor of the beneficiary.

After the trust agreement is created, the grantor must transfer any property he or she wants managed and distributed under the terms of the trust into the name of the trust – this is known as

[1] Wisconsin has a procedure allowing any heir of the decedent, trustee of a revocable trust created by the decedent, or person who was guardian of the decedent at the time of the decedent's death to use an affidavit to transfer estate property without more formal probate procedures or court involvement. This affidavit procedure is available when a decedent leaves property subject to administration in this state which does not exceed $50,000 in value. See Wis. Stat. § 867.03.

the *funding* process. The funding process must be done properly and thoroughly, or the property could wind up in probate. An <u>effective</u> funding process involves:

1) Transferring all bank accounts into the trust (many banking institutions do not require new account numbers, new checks or new debit cards);

2) Transferring all non-retirement investments into the trust (note that tax-deferred assets will be addressed later in this presentation);

3) Drafting and recording deeds transferring the grantor's ownership interest in all real estate (including oil and mineral interests) into the trust;

4) Transferring vehicle and boat titles into the trust, when appropriate;

5) Assigning all tangible personal property to the trust;

6) Naming the trust as the beneficiary of most life insurance policies and some annuities (depending on whether or not the annuity has any tax-deferred component); and

7) Transferring business interests to the trust, when appropriate. For example, often the grantor's membership interest in a limited liability company can be assigned to the trust and the grantor's interest in a corporation can be transferred to the trust by virtue of new stock certificates. However, a thorough review of each corporate book will be necessary.

Pour-Over Will: A "pour-over will" is a last will and testament that is designed to capture any assets that are not properly titled in the name of a revocable living trust. As explained previously, upon your death, any asset titled solely in your name, with no direct beneficiary designation, is typically subject to the probate process. A will is the only legal means to designate guardians for minor children. Therefore, *even if the client has a revocable living trust in place*, it will still be necessary to draft a pour-over will.

**Irrevocable Trusts**

In most circumstances, an irrevocable trust cannot be modified or terminated. The grantor, after transferring his or her assets into the irrevocable trust, effectively removes all of his or her rights of ownership in the assets and in the trust. This is the opposite of a revocable trust, which allows the grantor to modify the trust. However, note that a *revocable* living trust generally becomes *irrevocable* upon the death of the grantor. Irrevocable trusts can take on many forms and can be used to accomplish a variety of estate planning objectives.

For smaller estates, a Medicaid Planning Trust enables individuals or married couples to transfer some of their assets into an irrevocable trust, to hold and manage the assets throughout their lifetimes, for the purpose of Medicaid qualification while protecting an income stream for the benefit of the well spouse. Upon death, the remainder of the assets will be transferred to the designated beneficiaries in accordance with the provisions of the trust and are not subject to estate recovery. A Medicaid Planning Trust must be tailored to the laws of your state of residence and are subject to a "look-back" period.

## Alternatives to Living Trusts for Probate Avoidance

### Outright Gifts

An inter-vivos gift is given while you are living; a testamentary gift is given after you death through a written instrument. An outright gift of property, whether real or personal, is a voluntary and complete transfer from the owner of the property to another individual (or, in some cases, to a charity or another organization) without any payment or other consideration or expectation of anything in return for the gift.

Disadvantages of outright gifting:

1) You lose control over the gifted asset.

2) The gifted asset becomes subject to the claims of the recipient's creditors, possibly including the recipient's future ex-spouse.

3) There may be possible tax consequences.

Important note regarding cost basis: When you gift an asset to a beneficiary *during your lifetime* (including naming a beneficiary as a joint tenant or co-owner), the beneficiary inherits your original cost basis as to the interest gifted. Conversely, had your beneficiary inherited the asset *upon your death*, the entire asset would have received a "step-up" in cost basis on your date of death resulting in a possible reduction or elimination of the capital gains tax upon subsequent sale of the asset. Therefore, use caution when implementing gifting as a probate avoidance strategy with a large or highly appreciated asset unless you have first consulted with a CPA.

### Direct Beneficiary Designations

If you have named a direct beneficiary on your life insurance policy, retirement account or annuity, then that asset will pass directly to the named beneficiary(ies) on your death, outside of probate.

Payable on Death (POD) – If you have designated a "POD" beneficiary on your bank account, then the account will be paid on your death directly to the named beneficiary(ies).

Transfer on Death (TOD) – If you have designated a "TOD" beneficiary on your investment account or real estate, then that asset will be transferred on your death directly to the named beneficiary(ies).

Disadvantages: Even if your intent is for an insurance policy or bank account to be used to pay your funeral expenses after your death, the individual you have named as the direct beneficiary is under no legal obligation to use this money for its intended purpose. Further, this approach offers no protection to your beneficiaries.

## Common Mistakes to Avoid

Naming minor children as beneficiaries: Regardless of the provisions contained in your will, if you name a minor child as a direct beneficiary, the asset will most likely be paid out to your child outright as soon as he or she reaches the age of 18. Generally, if you have minor children and no revocable living trust, it is better to allow the asset to go through the probate process in order to ensure the proceeds are distributed to testamentary trusts established for your children according to the terms of your will.

Naming special needs individuals as beneficiaries: If you name a "special needs" individual (i.e., a person who is receiving a governmental benefit such as Supplemental Security Income (SSI) or medical assistance based on a disability) as a direct beneficiary, you could unintentionally disqualify that individual from receiving his or her valuable governmental benefits. The individual must then "spend down" the inheritance and, after virtually all the money has been spent, go through the application process again. If you wish to leave an inheritance for a loved one who is receiving this type of assistance, it is much better to create a "special needs trust," also known as a "supplemental needs trust," within your will or living trust to hold the inheritance for the benefit of that individual for his or her lifetime without jeopardizing his or her benefits.

Naming financially irresponsible individuals as beneficiaries: Naming this type of individual as a direct beneficiary may serve only to contribute to a gambling or drug addiction, or result in assets being claimed by creditors in a bankruptcy or income tax proceeding. Often, it is better to create a lifetime "spendthrift trust" to hold the inheritance for the benefit of that individual for his or her lifetime while protecting the assets from creditors.

Naming direct beneficiaries on all assets other than real estate: It is not unusual for the death probate process to take a year or longer. In the meantime, before your real estate can be sold or distributed, your estate is responsible for paying maintenance expenses including, but not limited to, real estate taxes, insurance, utilities, maintenance and general upkeep of the property. Your estate is also responsible for your final debts and expenses, including your funeral bill, court costs and attorney's fees. If you have insufficient cash available within your estate, then your children or other beneficiaries will need to find a way to pay these costs. However, they are under no legal obligation to pay these costs from life insurance proceeds, cash received through POD designations, etc. Therefore, if you own real estate that will go through probate upon your death, it is generally advisable to also allow your cash accounts and/or life insurance proceeds to go through probate as well in order to eliminate situations such as the one described above.