

Estate Planning Overview

Why Plan Your Estate?

The knowledge that we will eventually die is one of the things that seem to distinguish humans from other living beings. At the same time, no one likes to dwell on the prospect of his or her own death. But if you postpone planning for your passing until it is too late, you run the risk that your intended beneficiaries – those you love the most – may not receive what you would want them to receive either because of extra administration costs, unnecessary taxes or squabbling among your heirs.

This is why estate planning is so important, no matter how small your estate may be. It allows you to ensure that your assets and other possessions will go to the people you want, in the way you want, and when you want. It permits you to save as much as possible on taxes, court costs, and attorneys' fees and more importantly, it affords the comfort that your loved ones can mourn your loss without being simultaneously burdened with unnecessary red tape and financial confusion.

All estate plans should include, at minimum, two important estate-planning instruments: a durable power of attorney and a will. The first is for managing your property during your life in case you are ever unable to do so yourself. The second is for the management and distribution of your property after death. In addition more and more Americans also are using revocable (or "living") trusts to avoid the hassles of probate and to manage their estates both during their lives and after death.

Your Will

Your will is a legally binding statement directing who should receive your property at your death. It also appoints a legal representative to carry out your final wishes. However, a will covers only probate property. Many types of property or forms of ownership pass outside of probate. Jointly owned property, property held in trust, life insurance proceeds and other accounts with a named beneficiary, such as IRAs,

insurance policies or 401(k) plans, all pass outside of probate. Thus, there are non-probate assets.

Why should you have a will?

First, with a will you can direct where and to whom your assets (what you own) will go after your death. If you died intestate (without a will), your estate would be distributed according to state law. Such distribution may or may not be in accordance with your wishes. Many people try to avoid probate and the need for a will by holding all of their assets jointly with their children. This can work, but people often spend unnecessary effort trying to make sure all the joint accounts remain equally distributed among their children. These efforts can be defeated by a long-term illness of the parent or the death of a child. A will is a much simpler way to effectuate one's wishes about how assets should be distributed.

The second reason to have a will is to make the administration of your estate run smoothly. Often the probate process can be completed more quickly and at less expense to your estate if there is a will. With a clear expression of your wishes, costly, time-consuming disputes over who gets what are less likely.

Third, under a will you can choose the person you wish to administer your estate and distribute it according to your instructions. In Illinois this person is called your "personal representative". If you do not have a will naming him or her, the court will make the choice for you. Usually the court appoints the first person to ask for the post, which is most closely related to you at the time of death.

Fourth, for larger estates, a well planned will can help reduce estate taxes.

Fifth, and most important, through a will you can appoint who will take your place, as guardian of your minor children should both you and their other parent both pass away.

Filling out the worksheet that our office provides will help you make decisions about what to put in your will. Bring it and any additional notes to our office and our estate planning professionals will be able to efficiently prepare a will that meets your needs and desires.

Estate Administration- Probate Procedure

Probate is the process by which a deceased person's property, known as the "estate," is passed to his or her heirs and legatees (people named in the will). Generally the entire process, when supervised by the probate court, usually takes about one year. However, substantial distributions from the estate can be made in the interim.

The emotional trauma brought on by the death of a close family member is often accompanied by bewilderment about the financial and legal steps the survivors must take. The spouse who passed away may have handled all of the couple's finances. Or perhaps a child must begin taking care of probating an estate about which he or she knows little about. And this task may come on top of commitments to family and work that cannot be set aside. Finally, the estate itself may be in disarray or scattered amount many accounts, which is not unusual with a generation that saw banks collapse during the Depression.

Our office can set out the basic steps for a personal representative following the death of testator. These responsibilities will ultimately fall on whoever was appointed executor or personal representative in the deceased family member's will. Ideally, various steps will be taken right away to

First, secure the tangible property. This means anything you can touch, such as silverware, dishes, furniture, or artwork. You will need to determine accurate values of each piece of property, which may require appraisals, and then distribute the property as the deceased directed. If property is passed around to family members before you have the opportunity to take an inventory; this will become a difficult, if not impossible, task. Of course, this does not apply to gifts the deceased may have made during life, which will not be part of his or her estate.

Second, take your time. You do not need to take any other steps immediately. When bills do need to be paid, they can wait a month or two without adverse repercussions. It's more important that you and your family have time to grieve. Financial matters can wait. When you're ready but not a day sooner, meet with one of our attorneys to review the steps necessary to administer the deceased's estate. Bring as much information as possible about finances, taxes and debts. Don't worry about putting the papers in order first; our attorney will have experience in organizing and understanding confusing financial statements.

In general rules of estate administration include the following steps:

1. Filing the will and petition at the probate court in order to be appointed executor or personal representative. In the absence of a will, heirs must petition the court to be appointed "administrator" of the estate.
2. Marshalling, or collecting the assets. This means that you have to find out everything the deceased owned. You need to file a list, known as an "inventory", with the probate court. It's generally best to consolidate all of the estate funds to the extent possible. Bills and bequests should be paid from a single checking account, either one you establish or one set by our firm on your behalf, so that you can keep track of all expenditures.
3. Paying bills and taxes. If an estate tax return is needed—generally if the estate exceeds \$675,000 in value—it must be filed within nine months of the date of death. If you miss this deadline and the estate is taxable, severe penalties and interest may apply. If you do not have all of the information available in time, you can file for an extension and pay your best estimate of the tax due.
4. Filing tax returns. You must also file a final income tax return for the decedent and, if the estate holds any assets and earns interest or dividends, an income tax return for the estate. If the estate does earn income during the administration process, it will have to obtain its own tax identification number in order to keep track of such earnings and file an estate income tax return in addition to the decedent's final income tax return.
5. Distributing property to the heirs and legatees. Generally, executors do not pay out all of the estate assets until the period runs out for creditors to make claims, which in Illinois is 6 months from the date the estate, notice of death in the newspaper. But once the executor understands the estate and the likely claims, he or she can distribute most of the assets, retaining a reserve for unanticipated claims and costs of closing out the estate.

6. Filing a final account. The executor must file an account with the probate court listing any income to the estate since the date of death and all expenses and estate distributions. Once the court approves this final account, the executor can distribute whatever is left in the closing reserve, and finish his or her work

Avoiding probate through joint ownership or trusts can eliminate some of these steps. But whoever is left in charge still has to pay all debts, file tax returns, and distribute the property to the rightful heirs. You can make it easier for your heirs by keeping good records of your assets and liabilities. This will shorten the process and reduce the legal bill.

Guardianship and Conservatorship

Every adult is assumed to be capable of making his or her own decisions unless a court determines otherwise. If an adult becomes incapable of making responsible decisions due to a mental disability, the court will appoint a substitute decision maker, called a “guardian”. Guardianship is a legal relationship between a competent adult (the “guardian”) and a person who because of incapacity is no longer able to take care of his or her own affairs (the “ward”). The guardian is authorized to make legal, financial, and health care decisions for the ward. Depending on the terms of the guardianship, the guardian may or may not have to seek court approval for various decisions, but generally the guardian acts without being required to incur the expense of court approval.

Some incapacitated individuals can make responsible decisions in some areas of their lives but not others. In such cases, the court may give the guardian decision-making power over only those areas in which the incapacitated person is unable to make responsible decisions (a so-called “limited guardianship”). In other words, the guardian may exercise only those rights that have been removed from the ward and delegated to the guardian. Guardianships are consuming and expensive. Prefer planning with Power of Attorneys for health care and financial matters will significantly reduce cost and time in the event you became incapacitated. (See Page for detailed discussion of Power of Attorney).

Incapacity

Generally a person is judged to be in need of guardianship when he or she shows a lack of capacity to make responsible decisions. A person cannot be declared incompetent simply because he or she makes irresponsible or foolish decisions, but only if the person is shown to lack the *capacity* to make sound decisions. For example, a person may not be declared incompetent simply because he or she spends money in ways that seem odd to someone else. Also, a developmental disability or mental illness is not, by itself, enough to declare a person incompetent.

Process

Anyone interested in the proposed ward's well being can request a guardianship. An attorney is usually retained to file a petition for a hearing in the probate court in the proposed ward's county of residence. The proposed ward is entitled to legal representation at the hearing, and the court will appoint an attorney if the allegedly incapacitated person cannot afford lawyer.

At the hearing, the court with the help of the Guardian ad Litem attempts to determine if the proposed ward is incapacitated and, if so, to what extent the individual requires assistance. If the court determines that the proposed ward is indeed incapacitated, the court then decides if the person seeking the role of guardian will be responsible.

Guardian

A guardian can be any competent adult—the ward's spouse, another family member, a friend, a neighbor, or a professional guardian (an unrelated person who has received special training). A competent individual may nominate a proposed guardian through a durable power of attorney in case she ever needs a guardian.

The guardian need not be a person at all—it can be a non-profit agency or a public or private corporation. If a person is found to be incapacitated and a suitable guardian cannot be found, courts in many states can appoint a public guardian, a publicly financed agency that serves this purpose. In naming someone to serve as a guardian, courts give first consideration to those who play a significant role in the ward's life – people who are both aware of and sensitive to the ward's needs and preferences. If two individuals wish to share guardianship duties, courts can name co-guardians.

Reporting Requirements

Courts often give guardians broad authority to manage the ward's affairs. In addition to lacking the power to decide how money is spent or managed, where to live and what medical care he or she should receive, wards also may not have the right to vote, marry or divorce, or carry a driver's license. Guardians are expected to act in the best interests of the ward, but give the guardian's often-broad authority; there is the potential for abuse. For this reason, courts hold guardians accountable for their actions to ensure that they don't take advantage of or neglect the ward.

The guardian of the property inventories the ward's property, invests the ward's funds so that they can be used for the ward's support, and files regular, detailed reports with the court. A guardian of the property also must obtain court approval for certain financial transactions. Guardians must file an annual account of how they have handled the ward's finances. Guardians must offer proof that they made adequate residential arrangements for the ward, that they provided sufficient health care and treatment services, and that they made available educational and training programs, as needed. Guardians who cannot prove that they have adequately cared for the ward may be removed and replaced by another guardian.

Your Durable Power of Attorney

For most people, the durable power of attorney is the most important estate-planning instrument available—even more useful than a will. A power of attorney allows a person you appoint – your “attorney –in-fact “ – to act in your place for financial purposes when and if you ever become incapacitated.

In that case, the person you choose will be able to step in and take care of your financial affairs. Without a durable power of attorney, no one can represent you unless a court appoints a conservator or guardian. The court process takes time, costs money, and the judge may not choose the person you would prefer. In addition, under a guardianship or conservatorship, your representative may have to seek court permission to take planning steps that she could implement immediately under a simple durable power of attorney.

A power of attorney may be limited or general. A limited power of attorney may give someone the right to sign a deed to property on a day when you are out of

town. Or it may allow someone to sign checks for you. A general power is comprehensive and gives your attorney-in-fact all the powers and rights that you have yourself.

A power of attorney may also be either current or “Springtime”. Most powers of attorney take effect immediately upon their execution, even if understanding is that they will not be used until and unless the grantor becomes incapacitated. However, the document can also be written so that it does not become effective until such incapacity occurs. In the power of attorney be clearly laid out in the document itself.

While you should seriously consider executing a durable power of attorney, if you do not have someone you trust to appoint it may be more appropriate to have the probate court looking over the shoulder of the person who is handling your affairs through a guardianship or conservatorship. In that case, you may execute a limited durable power of attorney simply nominating the person you want to serve as your conservator or “guardian”.

Your Medical Directive

Any complete estate plan should include a medical directive. This term may encompass a number of different documents, including a durable power of attorney for health care and a living will. The exact document or documents will depend on the choices you make. This document designates someone you choose to make healthcare decisions for you if you are unable to do so yourself. A living will, discussed below, instructs your health care provider to withdraw life support if you are terminally ill or in a vegetative state.

Power of Attorney for Health Care

The statutory power of attorney for health care, mentioned above, is one example of a medical directive. The power of attorney is a much more efficient and powerful tool than the living will, but the living will has the advantage that it is self-actuating and needs nothing else but to be available when needed. The delay in locating the agent under a health care power of attorney may mean that the health care provider must act without the limitations expressed in the power of attorney, at least initially. If you are traveling when health care is needed, the existence of the living will may be easier to confirm through your physician or family members. It should also be noted that there may be a conflict between the directions in one document and those

contained in the other. In Illinois, the power of attorney takes precedence over the living will as long as an agent under the power is available to act. This issue is important if it is necessary to withdraw food and hydration, since doing so is prohibited in living wills in Illinois.

Living Will

Living wills, like many legal documents have certain strengths and certain weaknesses. It is often an advantage to have a self-actuating document that will allow the health care provider to withdraw or not commence artificial life support measures in the limited circumstances prescribed by the statutory language of the living will, especially when the agent named in a power of attorney for health care is unavailable on an emergency basis. However, the limitation imposed by the statutory language, which requires the maintenance of food and water, may frustrate the intent of the terminally ill person, and that limitation is not a factor with an agent under a power of attorney for health care unless the principal specifically imposes that restriction.

Mental Capacity Requirements

Proper execution of a legal instrument requires that the person signing have sufficient mental “capacity” to understand the implications of the document. While most people speak of legal “capacity” or “competence” as a rigid black line—either the person has it or doesn’t—in fact it can be quite variable depending on the person’s abilities and the function for which capacity is required.

One side of the capacity equation involves the client’s abilities, which may change from day to day (or even during the day), depending on the course of the illness, fatigue and the effects of medication. On the other side, greater understanding is required for some legal activities than for others. For instance, the capacity required for entering into a contract is higher than that required executing a will.

The standard definition of capacity for wills has been aptly summed up by one court as follows:

Testamentary capacity requires ability on the part of the testator to understand and carry in mind, a general way, the nature and situation of his property and his relations to those persons who would naturally have some claim to his remembrance. It requires freedom from delusion which is the

effect of disease or weakness and which might influence the disposition of his property. And it requires ability at the time of execution of the alleged will to comprehend the nature of the act of making a will.

That is a relatively “low threshold,” meaning that signing a will does not require a great deal of capacity. The fact that the next day the testator does not remember the will signing and is not sufficiently “with it” to execute a will then does not invalidate the will if he understood it when he signed it.

The standard of capacity with respect to durable powers of attorney varies from jurisdiction to jurisdiction. Some courts and practitioners argue that this threshold can be quite low. The client need only know that he trusts the attorney-in-fact to manage his financial affairs. Others argue that since the attorney-in-fact generally has the right to enter into contracts on behalf of the principal, the principal should have capacity to enter into contracts as well. The threshold for entering into the contracts is fairly high. The standards for entering into a contract are different because the individual must know not only the nature of her property and the person with whom she is dealing, but also the broader context of the market in which she is agreeing to buy or sell services or property. One court defined the competency required to execute a contract as follows:

Competency to enter into a contract presupposes something more than a transient surge of lucidity. It requires the ability to comprehend the nature and quality of the transaction; together with an understanding of what are “going on”, but an ability to comprehend the nature and quality of the transaction, together with an understanding of its significance and consequences.

As a practical matter, in assessing a client’s capacity to execute a legal document, attorneys generally ask the question “Is anyone going to challenge this transaction?” If a client of questionable capacity executes a will giving her estate to her husband and then to her children if her husband does not survive her, it’s unlikely to be challenged. If, on the other hand, she executes a will giving her estate entirely to one daughter with nothing passing to her other children, the attorney must be more certain of being able to prove the client’s capacity.

While the standards may seem clear, applying them to particular clients may be difficult. The fact that a client does not know the year or the name of the

President may mean that she does not have capacity to enter into a contract, but not necessarily that she can't execute a will or durable power of attorney. The determination mixes medical, psychological and legal judgments. It must be made by the attorney (or a judge, in the case of guardianship and conservator ship determinations) based on information gleaned by the attorney in interactions with the client, from the other sources such as family members and social workers, and, if necessary, from medical personnel. Doctors and psychiatrist cannot themselves make a determination as to whether an individual has capacity to undertake a legal commitment. But they can provide a professional evaluation of the person that will help an attorney make this decision.

Because you need a third party to assess capacity and because you need to be certain that the formal legal requirements are followed, it can be risky to prepare and execute legal documents on your own without representation by an attorney.

Trusts

Trusts have one set of beneficiaries during their lives and another set – often their children – who begin to benefit only after the first group has died. The first are often called “life beneficiaries” and the second “remaindermen”.

Uses of Trusts

There can be several advantages to establishing a trust, depending on your situation. Best-known is the advantage of avoiding probate. In a trust that terminates at the death of the person who creates it (the “grantor”), any property in the trust prior to the grantor's death passes immediately to the beneficiaries by the terms of the trust without requiring probate. Think of a trust much like a legally binding contract that the trustee must follow. By avoiding probate, trusts save time and money for the beneficiaries. Certain trusts can also result in tax advantages both for the grantor and the beneficiary. These are often referred to as “credit shelter” or “life insurance” trusts. Other trusts may be used to protect property from creditors or to help donor qualify for Medicaid. Unlike wills, trusts are private documents and only those individuals with a direct interest in the trust need know of the trust assets or then distributions. Provided they are well drafted, another advantage of trusts is their continuing effectiveness even if the grantor dies or becomes incapacitated.

Kinds of Trusts

Trusts fall into two basic categories: testamentary and inter vivos. A testamentary trust is one created by your will, and it does not come into existence until you die. In contrast, an inter vivos trust starts during your lifetime. You create it now and it exists during your life. There are two kinds of inter vivos trusts: revocable and irrevocable.

Revocable Trust

Revocable trusts are often referred to as “living” trusts. With a revocable trust, the grantor maintains complete control over the trust and may amend, revoke or terminate the trust at any time. This means that you, the grantor, can take back the funds you put in the trust or change the trust’s terms. Thus, the grantor is able to reap the benefits of the trust arrangement while maintaining the ability to change the trust at any time prior to death or incapacity. Revocable trusts are generally used for the following purposes:

Asset Management

They permit the named trustee to administer and invest the trust property for the benefit of one or more beneficiaries.

Probate Avoidance

At the death of the person who created the trust, the trust property passes to whoever is named in the trust. It does not come under the jurisdiction of the probate court and the probate process need not hold up its distribution or diminish its value by extra cost. However, the property of a revocable trust will be included in the grantor’s estate for estate purposes.

Tax Planning

While the assets of a revocable trust will be included in the grantor’s taxable estate, the trust can be drafted so that the assets will not be included in the estates of the beneficiaries, thus avoiding taxes when the beneficiaries die.

Irrevocable Trust

An irrevocable trust cannot be changed or amended by the donor. The trustee as provided for in the trust document it may only distribute property placed into the trust according to the trust specific terms. For instance, the donor may set up a trust under which he or she will receive income earned on the trust property, but that bars access to the trust principal. This type of irrevocable trust is a popular tool for Medicaid planning and/or estate tax planning.

Testamentary Trusts

As noted above, a testamentary trust is a trust created by a will. Such a trust has no power or effect until the will of the grantor is probated. Although a testamentary trust will not avoid the need for probate and will become a public document, as it is a part of the will, it can be useful in accomplishing other estate planning goals. For instance, the testamentary trust can be used to reduce estate taxes on the death of a spouse or provide the care of a disabled or minor child.

Supplemental Needs Trusts

The purpose of a supplemental needs trust is to enable the donor to provide the continuing care of a disabled spouse, child, relative or friend. The beneficiary of a well-drafted supplemental needs trust will have access to the trust assets for purposes other than those provided by public benefits programs. In this way, the beneficiary will not lose eligibility for benefits such as Supplemental Security Income, Medicaid and low-income housing. A supplemental needs trust can be created by the donor during life or be part of a will.

Estate Taxation

Under the tax law enacted in 2001, whatever you own is subject to the federal estate tax upon your death, until 2010. For the year 2010, estates will be entirely free from federal taxation. However, the law that includes these provisions expires at the end of 2010. Thus, unless Congress acts in the interim, the estate tax rules will then revert to those prevailing in 2001. For 2001, the tax rate on estates begins at 37

percent and rises to a maximum of 55 percent, depending on how much is being passed to your heirs.

Illinois has an estate tax. But this is a so-called “sponge” tax, which ultimately doesn’t cost your estate. The way this works is that Illinois takes advantage of a provision in the federal estate tax permitting a deduction for taxes paid to the state up to certain limits. Illinois simply takes the full amount of what you are allowed to deduct off the federal taxes.

Federal Estate Taxes

| | | |
|------|-----------|-----------|
| 2010 | Unlimited | Unlimited |
| 2011 | 55% | 1,000,000 |

Making Gifts: The \$10,000 Annual Rule

One simple way you can reduce estate taxes or shelter assets in order to achieve Medicaid eligibility is to give some or all of your estate to your children (or anyone else) during their lives in the form of gifts. Certain rules apply, however. There is no actual limit on how much you may give during your lifetime. But if you give any individual more than \$10,000 during a calendar year, you must file a gift tax return reporting the gift to the IRS. Also the amount above \$10,000 will be counted against the unified exempt equivalent that you may give tax-free during your life or upon your death.

The \$10,000 figure is an exclusion from the gift tax-reporting requirement. You may give \$10,000 to each of your children, their spouses, and your grandchildren (or to anyone else you choose) each year without reporting these gifts to the IRS. In addition, if you’re married, your spouse can duplicate these gifts. For example, a married couple with four children can give away up to \$80,000 a year with no gift tax implications. In addition, the gifts will not count as taxable income to your children.