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APPLICATIONS OF THE WISCONSIN MARITAL PROPERTY ACT TO ESTATE PLANNING: A PRACTICAL DISCUSSION ON SELECTED ASPECTS OF THE ACT

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Wisconsin's Marital Property Act¹ will have many and varied effects on the estate planning attorney's practice. The Act is based on the Uniform Marital Property Act (UMPA)² with some modifications. This Article will discuss selected aspects of the Act and analyze its effect on estate planning. The first section contains a general discussion of the Act's provisions which affect estate planning. The second section discusses various planning and practice applications of the Act's provisions.

I. INTRODUCTION TO ACT PROVISIONS WHICH AFFECT ESTATE PLANNING

A. *Classifications*

Under the Act, ownership of property by spouses is determined by classification, not by title, as of the determination date.³ Property is classified as: (1) marital property, which generally consists of all property acquired during the marriage

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1. 1983 Wis. Laws 186.

2. UNIF. MARITAL PROP. ACT, 9A U.L.A. 21 (Supp. 1985) [hereinafter cited as UMPA].

3. The determination date is the later of the date of marriage, the effective date of the Act (January 1, 1986), or the date marital domicile is established in Wisconsin. See 1983 Wis. Laws 186, § 47 (to be codified at WIS. STAT. § 766.01(5)). Neither the Act, the UMPA provisions, nor the UMPA comments defines marital domicile. However, marital domicile is established under UMPA when a couple moves into the state. See UMPA, *supra* note 2, § 1 comment.

and after the determination date;⁴ (2) deferred marital property, which generally consists of all property acquired during the marriage and before the determination date;⁵ or (3) individual property, which generally consists of all property acquired by the individual as sole property before the date of marriage or during marriage by gift or inheritance or as a distribution from a trust created by a third person.⁶

In addition to the three basic property classifications, the Act creates the classification of survivorship marital property.⁷ Spouses may hold marital property in a form which designates the holders by the words "husband and/or wife as survivorship marital property."⁸ The effect of this designation is that "[o]n the death of a spouse, the ownership rights of that spouse in the property vest solely in the surviving spouse by nontestamentary disposition at death. The first deceased spouse may not dispose at death of any interest in survivorship marital property."⁹ A homestead acquired by spouses after the determination date will be presumed to be survivorship marital property unless a contrary intent is shown by the instrument of transfer.¹⁰

Financial obligations incurred by spouses during the marriage are also classified. All obligations are presumed to be incurred in the interest of the marriage.¹¹ Such obligations can be satisfied from all of the marital property of both spouses and the individual property of the incurring spouse.¹² All other obligations incurred during the marriage can be satisfied from the individual property and the deferred marital property of the incurring spouse, and then that spouse's interest in marital property, in that order.¹³ Obligations incurred by a spouse before marriage may be satisfied only from that spouse's individual property and deferred marital property,

4. See 1983 Wis. Laws 186, § 47 (to be codified at WIS. STAT. §§ 766.31(1) - (5)).

5. See *id.* (to be codified at WIS. STAT. § 766.77).

6. See *id.* (to be codified at WIS. STAT. § 766.31(7)).

7. See *id.* (to be codified at WIS. STAT. § 766.60(4), (5)).

8. *Id.* (to be codified at WIS. STAT. § 766.60 (1),(2), (5)).

9. *Id.* (to be codified at WIS. STAT. § 766.60(5)).

10. See *id.*

11. See *id.* (to be codified at WIS. STAT. § 766.55(1)).

12. See *id.* (to be codified at WIS. STAT. § 766.55(2)(a)).

13. See *id.* (to be codified at WIS. STAT. § 766.55(2)(d)).

and from the portion of marital property which would have been the property of the spouse but for the marriage.¹⁴

Upon the death of a spouse, the personal representative must classify all obligations as either marital or individual obligations. Marital obligations are paid from the marital property of both spouses. Individual obligations are payable out of a decedent's individual property and then from the decedent's interest in marital property.¹⁵ At death, deferred marital property becomes marital property.¹⁶

The classification of life insurance policies and their proceeds depends on three factors: (1) the owner listed on the insurance company's records; (2) the date the policy was issued; and (3) the classification of the funds used to pay the premiums.¹⁷ This classification is further complicated by the concept of deferred marital property. After the death of the owning spouse, the deferred marital property rules cause the date of marriage, rather than a later determination date, to be used to determine the marital and individual property portions.

The Act contains a straddle provision to classify a deferred employment benefit attributable to employment partly before and partly after the determination date.¹⁸ The marital property component of the deferred employment benefit is determined by multiplying the entire benefit by the period of employment after the determination date, divided by the total period of employment.¹⁹ As with life insurance, the deferred marital property rules cause the date of marriage, rather than a later determination date, to be used to determine the marital and individual property portions after the death of the employee spouse.

The Act contains a provision, not found in UMPA, which states that "[t]he marital property interest of the nonemployee spouse in a deferred employment benefit plan terminates at the death of the nonemployee spouse if he or she predeceases

14. *See id.* (to be codified at WIS. STAT. § 766.55(c)).

15. *See id.* § 70 (to be codified at WIS. STAT. § 859.18).

16. *See id.* § 47 (to be codified at WIS. STAT. § 766.77(1)).

17. *See id.* (to be codified at WIS. STAT. § 766.61). A table which shows the classification of life insurance policies and their proceeds is provided in Appendix A.

18. *See id.* (to be codified at WIS. STAT. § 766.62(2)).

19. *See id.*

the employe spouse.”²⁰ This provision is known as the “terminable interest rule.”

B. *Management and Control*

The management and control rights of a spouse over property are determined by both the classification of, and title to, the property. Individual property and deferred marital property are managed and controlled by the spouse having title.²¹ Marital property titled only in one spouse's name is controlled by that spouse.²² However, a court, upon petition, can add the name of the other spouse to the title of marital property other than: (1) an interest in a general partnership; (2) an asset of an unincorporated business in which only the titled spouse is involved in the operation or management; (3) an interest in a professional association or service corporation; (4) an interest in a close corporation of which the titled spouse is an employee; or (5) any other property if the addition would adversely affect the rights of a third person.²³ A spouse acquires management and control rights when a court adds the spouse's name to the title.

Marital property titled to both spouses as husband and wife is controlled by the spouses acting together.²⁴ All other marital property can be controlled by either spouse without the consent of the other spouse.²⁵ A spouse with management and control rights has the right to buy, sell, transfer, exchange, assign, and encumber or otherwise deal with the property as if that spouse were an unmarried person.²⁶

Upon the death of a spouse, the personal representative has title to all property of the decedent. The personal representative may petition the court to determine the classification of property and “for other equitable relief necessary for management and control of the marital property during the administration of the estate.”²⁷

20. *Id.* (to be codified at WIS. STAT. § 766.62(5)).

21. *See id.* (to be codified at WIS. STAT. § 766.51(1)(a)).

22. *See id.* (to be codified at WIS. STAT. § 766.51(1)(am)).

23. *See id.* (to be codified at WIS. STAT. § 766.70(3)).

24. *See id.* (to be codified at WIS. STAT. § 766.70(2)).

25. *See id.* (to be codified at WIS. STAT. § 766.51).

26. *See id.* (to be codified at WIS. STAT. § 766.01(11)).

27. *Id.* § 66 (to be codified at WIS. STAT. § 857.01).

C. Marital Agreements

A marital agreement is an agreement between spouses with respect to the property owned by either or both. Consideration is not required.²⁸ The Act contains additional requirements²⁹ including financial disclosure and representation by attorneys.³⁰

A marital agreement can be used with respect to: (1) rights and obligations concerning property; (2) management and control of property; (3) a disposition of the property of spouses upon dissolution of marriage or death or the occurrence or nonoccurrence of any other event; (4) a will, trust, or other arrangement to carry out the marital agreement; (5) the descent of the property of either spouse without probate, to a designated person, trust, or other entity by nontestamentary disposition; (6) the choice of law governing a marital agreement; (7) any other matter affecting the spouses' property not in violation of public policy or criminal statute.³¹ Marital agreements may not adversely affect the right of a child to support, the rights of a bona fide purchaser, the rights of a creditor without actual knowledge of the agreement, or the obligation of good faith between spouses.³²

D. Special Aspects of the Act Affecting Estate Planning

Gifts, inheritances, and trust distributions are methods allowed by the Act to transfer property to one spouse as that spouse's individual property.³³ A gift from one spouse to the other can reclassify marital property, deferred marital property, or both to individual property.³⁴ A spouse may not reclassify property by placing it in a trust: "Marital property transferred to a trust remains marital property."³⁵

28. See *id.* § 47 (to be codified at WIS. STAT. § 766.58(1), (3)(a)).

29. See *id.* (to be codified at WIS. STAT. § 766.58).

30. For a detailed discussion of marital agreements, see generally Roberson & Langer, *Marital Agreements: An Important Financial Planning Tool*, WIS. B. BULL., July 1984, at 29.

31. See 1983 Wis. Laws 186, § 47 (to be codified at WIS. STAT. § 766.58(3)).

32. See *id.* (to be codified at WIS. STAT. § 766.58(2)).

33. See *id.* (to be codified at WIS. STAT. § 766.31(7)(a)).

34. See *id.* (to be codified at WIS. STAT. § 766.53).

35. See *id.* (to be codified at WIS. STAT. § 766.31(10)).

The amount of marital property which a spouse acting alone can give to a third person under the Act is limited to \$500 per calendar year or a larger amount that is reasonable in light of the economic position of the spouses. Both spouses acting together can make a larger gift of marital property. If a larger gift is made without the nondonating spouse's consent, that spouse can bring an action to recover the excess amount of the gift from either the donating spouse, the third person, or both.³⁶

If a spouse dies intestate, the surviving spouse will receive the entire estate of the decedent if there are no children or if the children are those of the decedent and the surviving spouse.³⁷ If there are surviving issue of the decedent that are not also issue of the surviving spouse, the surviving spouse will receive one-half of the decedent's individual property in addition to one-half of the marital and one-half of the deferred marital property. The remainder of the estate is divided among the surviving issue.³⁸ The post-mortem election against the will by the surviving spouse is terminated for deaths occurring after January 1, 1986.³⁹

A significant advantage of becoming a community property state is that both halves of appreciated marital property will receive a stepped up basis for income tax purposes upon the death of either spouse.⁴⁰ A step up in basis for both halves of an item of marital property is only available if at least one-half of the value of that item is includable in the decedent's estate for estate tax purposes.⁴¹ All of a decedent's marital property and deferred marital property will receive a stepped up basis.

For estate tax purposes, "[t]he value of the gross estate shall include the value of all property to the extent of any interest therein of the decedent at the time of his death."⁴²

36. *See id.* (to be codified at WIS. STAT. § 766.31(5)).

37. *See id.* § 59 (to be codified at WIS. STAT. § 852.01(1)(a)(1)).

38. *See id.* § 61 (to be codified at WIS. STAT. § 852.01(1)(a)(2)).

39. *See* WIS. STAT. § 861.05, *repealed by* 1983 Wis. Laws 186, § 77.

40. The Internal Revenue Service has not ruled whether Wisconsin's marital property system is community property for federal tax purposes.

41. *See* I.R.C. § 1014(b)(6) (1985). *See also* 1983 Wis. Laws 186, § 11 (to be codified at WIS. STAT. § 71.05(1)(g)).

42. I.R.C. § 2033 (1985).

Therefore, for estate tax purposes, the decedent's estate will include: (1) all individual property of the decedent; (2) one-half of the marital property of the spouse;⁴³ and (3) all of the deferred marital property which was owned by the decedent.⁴⁴ Wisconsin's inheritance tax applies to the recipients of property from a decedent.⁴⁵ Inheritance taxes may increase or decrease if different amounts are received from the decedent due to the change in the ownership of property under the Act.

II. PLANNING AND PRACTICE APPLICATIONS

A. *Ownership of Property*

The greatest impact on existing estate plans is caused by the changes in classification of property of the spouses. An effective estate plan requires a determination of ownership of specific property upon the death of a spouse. The classification in an estate plan will have to be done twice, once assuming the husband dies first and once assuming the wife dies first, because deferred marital property becomes marital property upon the owning spouse's death.⁴⁶

Upon the death of a spouse all of the property owned by the spouse will be classified by the personal representative.⁴⁷ Under Texas community property law, if the classification of any item is improper and the item is distributed to the wrong person, a constructive trust is imposed upon that property for the benefit of the person who should have received the property.⁴⁸ The Wisconsin courts may or may not impose such a constructive trust.

A decedent's estate will include the decedent's individual property, one-half of each item of the spouses' marital property, and one-half of each item of the decedent's deferred mar-

43. See, e.g., *Sampson v. Welch*, 23 F. Supp. 271 (S.D. Cal. 1938) (a wife owns a legal and present share in community property which is not included in her husband's taxable estate).

44. See, e.g., *Estate of Frank Sbicca*, 35 T.C. 96, 105 (1960) (all of a spouse's California *quasi* marital property (similar to Wisconsin deferred marital property) is taxable to the estate of a decedent since the property is not converted into community property during the lifetime of the spouse).

45. See WIS. STAT. § 72.11 (1983-84).

46. See 1983 Wis. Laws 186, § 47 (to be codified at WIS. STAT. § 766.77).

47. See *id.* § 69 (to be codified at WIS. STAT. § 858.01).

48. See, e.g., *Estate of Bailey v. Commissioner*, 741 F.2d 801 (5th Cir. 1984).

ital property. Upon the death of a spouse, the surviving spouse owns each item of the decedent's marital and deferred marital property as a tenant in common with third parties who succeed to the decedent's interest of the property.⁴⁹ As a consequence, a spouse cannot make a specific bequest to a third person of an entire item of marital property, but can only give a one-half interest in the property. The beneficiary will be a tenant in common with the surviving spouse.

If the spouses own stock of a corporation as marital property, both spouses should sign the election to be taxed as an "S" corporation, even if the stock is titled in the name of only one spouse. Both spouses should sign because the election is valid only if *all* stockholders of a corporation sign.⁵⁰ A non-titled spouse with a marital property interest in stock may be considered a shareholder.⁵¹

The ownership of property by married couples that move out of the state and then return is determined by the laws of the state of domicile when the property was acquired. Ownership is not changed by a subsequent move.⁵² While the Act is unclear, it appears that such couples may have a second determination date upon re-establishing residence in Wisconsin. The property acquired during residency in the other state would probably be classified as deferred marital property.

B. Survivorship Marital Property and Joint Tenancies

Joint tenancies existing at the determination date will be classified under the Act. The Act is unclear as to the effect of classification. The result may be that the survivorship aspect of the joint tenancy may be abrogated when the deed does not specifically provide that the property is survivorship marital property. This problem can be solved by a marital property agreement.

The Wisconsin Legislative Council Special Committee on Marital Property Implementation has recommended that the

49. See 1983 Wis. Laws 186, § 75 (to be codified at Wis. STAT. § 861.01(2)).

50. See I.R.C. § 1362(a)(2) (1985).

51. See *Forrester v. Commissioner*, 49 T.C. 499 (1968) (a wife with a community property interest in stock must file a consent for a Subchapter S election to be effective even though the husband was the sole manager of the stock under state law).

52. See EST. PLAN. & TAX'N COORDINATOR (RIA) ¶ 28,109 (1982).

legislature amend the Act to provide: (1) "that post-Act joint tenancies exclusively between spouses should be treated as survivorship marital property" and (2) "that all property acquired by spouses after the effective date . . . with a survivorship feature is survivorship marital property."⁵³ The committee staff has been directed to clarify that the survivorship element of pre-Act joint tenancies applies to any marital property in the joint tenancy.⁵⁴

Property owned by a spouse and a third person as joint tenants may have a marital property component. If the joint tenancy property was purchased by the spouse with individual property, that spouse's interest in the joint tenancy will be individual property and will pass to the third-party joint tenant in its entirety. If, however, the property was purchased in whole or in part with marital property or deferred marital property, the surviving spouse has a marital property interest in the property. As a result, the entire property may not pass to the third party upon the owning spouse's death. All existing joint tenancies should be examined to determine the Act's effects and to determine if action should be taken to reflect the intent of the parties.

C. *Classification of Obligations*

The classification of obligations gives a spouse the opportunity to preserve and maximize individual property by not using individual funds to pay marital obligations. Marital obligations should be paid first from marital property and then from deferred marital property. If sufficient liquid marital assets are not available, a spouse could obtain a loan to pay the marital obligations and avoid the loss of individual property. The loan would be classified as an obligation in the interest of marriage because it would be used to pay a marital obligation. A spouse can also maximize and preserve individual property by paying nonmarital obligations from deferred marital property.

53. WISCONSIN LEGISLATIVE COUNSEL, SUMMARY OF PROCEEDINGS OF THE SPECIAL COMMITTEE ON MARITAL PROPERTY IMPLEMENTATION 4 (August 28, 1984).

54. *See id.* at 3-5.

D. *Special Assets*

For life insurance proceeds to be individual property, a spouse must maintain records back to the date of marriage to show that no premiums were paid from marital or deferred marital property. Also, any life insurance policy issued after the determination date designating the insured spouse as the owner will be marital property even if all premiums were paid from the owner's individual property.⁵⁵

An individual retirement account which arises from an employee's wage deposits is not a deferred employment benefit. Therefore, the terminal interest rule does not apply, and the non-employee spouse will have a marital or deferred marital interest.

E. *Management and Control: Effects on Closely Held Businesses*

The Act's provisions regarding ownership of property⁵⁶ and management and control of property⁵⁷ raise complicated issues regarding the buy-sell agreements used as estate planning tools for owners of closely held businesses.

The general rule is that the titled spouse has management and control rights of all property titled in that spouse's name alone.⁵⁸ Therefore, a spouse who owns an interest in a closely held business titled solely in that spouse's name, will have sole management and control rights regardless of how the property is classified under the Act. These management and control rights are broad enough for the spouse to execute a binding buy-sell agreement controlling the sale or transfer of marital property or otherwise encumbering that property.⁵⁹

The titled spouse has a duty of good faith regarding a spouse's marital property interest in the business.⁶⁰ This duty could be violated if a buy-sell agreement provided for the transfer of stock to a third party for inadequate consideration. The spouse's remedy under the Act is an action against the

55. See 1983 Wis. Laws 186, § 47 (to be codified at WIS. STAT. § 766.61(3)(a)).

56. See *id.* (to be codified at WIS. STAT. § 766.31).

57. See *id.* (to be codified at WIS. STAT. § 766.51).

58. See *id.* (to be codified at WIS. STAT. § 766.51(1)).

59. See *id.* (to be codified at WIS. STAT. § 766.01(11)).

60. See *id.* (to be codified at WIS. STAT. § 766.15).

titled spouse.⁶¹ The Act does not provide that the buy-sell agreement can be voided by a judgment, and the rights of the other parties to the buy-sell agreement are not described in the Act.

If the titled spouse is not an employee, the Act allows a court to order the nontitled spouse to be named as a stockholder.⁶² Placing the spouse's name on the stock will transfer an interest in the stock so that the individual acquires management and control rights, including voting rights. Placing a spouse's name on the stock certificates may activate the right to buy specified in the agreement. It could be argued that a court may not order the name of a spouse to be placed on stock when a buy-sell agreement exists because doing so could adversely affect the rights of stockholders other than the married couple.⁶³

If a nontitled spouse dies, that spouse's marital property interest in ownership of the business will become part of the spouse's estate. If the decedent's will transfers the interest to a third person, the buy-sell agreement may be activated. A buy-sell agreement may also be activated when a nontitled spouse obtains a marital property interest in the business or when a property agreement reclassifies property as marital. The Act purports to minimize these problems by providing that buy-sell agreements in existence before January 1, 1986 will be controlled by the present law.⁶⁴ It is not known how the courts will interpret this provision. Therefore, a buy-sell agreement should be reviewed under the Act and modified if necessary.

Many of the problems outlined above can be avoided if both spouses sign the buy-sell agreement. Alternatively, spouses may enter into a marital agreement listing the other owners as third-party beneficiaries to assure that the marital agreement will not be modified without the other owners' consent. New agreements between all owners and their spouses should also be considered.

61. *See id.* (to be codified at WIS. STAT. § 766.70(1)).

62. *See id.* (to be codified at WIS. STAT. § 766.70(3)).

63. *See id.* (to be codified at WIS. STAT. § 766.70(3)(e)).

64. *See id.* (to be codified at WIS. STAT. § 766.90(2)).

F. Marital Agreements

Marital agreements will become a necessity in most estate plans. The spouses can agree as to the disposition of any of the property upon dissolution of marriage or death or any other event.⁶⁵ A nontestamentary disposition of property upon the death of a spouse through a marital agreement is commonly known as a "Washington Will."⁶⁶ Such an agreement will transfer property to any person or entity without probate.⁶⁷ The Washington Will is a means of avoiding probate. However, since the provisions of a Washington Will are contained in a marital agreement, they can only be amended or revoked by a later marital agreement.⁶⁸

Several problems may occur with the use of marital agreements. First, a subsequent will does not revoke a marital agreement under the Act. A new marital agreement *must* be made to comply with the new terms of the will in order to make the will effective. The estate planner should consider execution of a marital agreement at the time of the execution of the will of each spouse. Second, marital agreements need only be written and signed by the parties. The lack of the formalities of a will and the competency of the drafting attorney may cause significant litigation. Third, there have been suggestions that marital agreements can be made which require the application of the current property law thus excluding the effects of the Wisconsin Marital Property Act. One questions the effectiveness of such agreements and the difficulties which may arise under them as well as the justification of attorneys' reliance on such agreements given the fact that the Act has been made effective a year and nine months after it became law.⁶⁹ Finally, to preserve particular classifications, spouses will be required to reconstruct and maintain detailed

65. *See id.* (to be codified at WIS. STAT. § 766.58(3)(c)).

66. Washington has had a similar statute in effect since 1881. *See* WASH. REV. CODE § 26.16.120 (1985).

67. *See* 1983 Wis. Laws 186, § 47 (to be codified at WIS. STAT. § 766.58(3)(f)).

68. *See id.* (to be codified at WIS. STAT. § 766.58(4)).

69. For a detailed discussion of the use of marital agreement provisions which may be used to "opt out" of Wisconsin's Marital Property law, see Drought, *Marital Agreements After 1985*, in MARITAL AGREEMENTS: CUSTOMIZING A COUPLE'S OWNERSHIP RIGHTS 69-70 (ATS-CLE ed. 1984).

records, many of them generated years after the fact. This problem can be avoided by the terms of a marital agreement.

G. Gifts, Inheritances, and Trusts

Gifts, bequests, and distributions from trusts are methods of transferring property to a married person as that person's individual property. A third person who wishes to give property to a married person as that person's individual property can transfer a lump sum as a gift or a bequest or can create a trust to provide the beneficiary with periodic payments of individual property.⁷⁰

The annual \$500 or "reasonable" limit on gifts of marital property to third persons without the consent of the spouse⁷¹ makes it necessary to know the classification of property given away. The Act mentions gifts to third persons, and the drafters' comments to the UMPA speak of gifts to one individual.⁷² It is not clear whether the limitation on gifts applies to charitable organizations. To avoid these issues, all gifts of marital property above the limitation and gifts to charitable organizations should be joined or consented to by both spouses. If the nondonating spouse does not consent to the gift of marital property, the donor can make the gift from that spouse's individual property or deferred marital property. A surviving spouse has no right to object to the gift of deferred marital property since ownership of deferred marital property remains with its title holder and is only treated as marital property if it is owned by a spouse at death.⁷³

Gifts of property can be made between spouses to reclassify the property.⁷⁴ Since all property is presumed to be marital property,⁷⁵ a gift which is intended to reclassify property should be carefully documented. The Act does not specify the elements required for a gift to reclassify spousal property. Therefore, an effective gift must meet the elements established by Wisconsin law: (1) intention to give on the part of the donor; (2) delivery, actual or constructive, to the donee; (3) ter-

70. See 1983 Wis. Laws 186, § 47 (to be codified at WIS. STAT. § 766.31(7)(a)).

71. See *id.* (to be codified at WIS. STAT. § 766.53).

72. See UMPA, *supra* note 2, § 6 comment.

73. See 1983 Wis. Laws 186, § 47 (to be codified at WIS. STAT. § 766.77).

74. See *id.* (to be codified at WIS. STAT. § 766.31(10)).

75. See *id.* (to be codified at WIS. STAT. § 766.31(2)).

mination of the donor's dominion over the subject of the gift; and (4) dominion by the donee.⁷⁶

H. *Income, Estate, and Inheritance Taxes*

The classification of property under the Act will result in a greater or lesser amount of property being owned by each spouse at death than before the Act. Therefore, the attempted optimum use of the unlimited marital deduction⁷⁷ and the unified credit⁷⁸ in current estate plans must be reviewed in light of the provisions of the Act.

All deferred marital property is included in the decedent's estate for estate and inheritance tax purposes even though it has become marital property at death and half-owned by the surviving spouse.⁷⁹ The one-half of deferred marital property passing to the spouse is not taxable for federal estate or Wisconsin inheritance tax purposes because of the unlimited marital deduction and spousal exemption.

Marital property is included in the decedent's estate to the extent of one-half. However, that one-half and the one-half belonging to the surviving spouse both get a step up in basis, for federal and Wisconsin income tax purposes, to market value at death or the alternate valuation date.⁸⁰ Reclassification of property by a marital agreement from individual, deferred, or both to marital may be advantageous to obtain the step up in income tax basis of the one-half of the property owned by the surviving spouse which will be untaxed.

If the decedent wills the marital property to the spouse, there will be no tax cost to the step up in basis of the other one-half of the property. If a decedent's one-half of marital property is willed to a third party, there may be a federal and Wisconsin tax applicable to that one-half of the property; this will be a tax cost of the step up. If the reclassification occurs within one year of the death of the donee spouse, no amount

76. See, e.g., *In re Reist*, 91 Wis. 2d 209, 218, 281 N.W.2d 86, 90 (1979); *Hoffmann v. Wausau Concrete Co.*, 58 Wis. 2d 472, 484, 207 N.W.2d 80, 86 (1973).

77. See I.R.C. § 2056 (1985). See also WIS. STAT. § 72.15(5) (1983-84).

78. See I.R.C. § 2010 (1985).

79. See *supra* text accompanying notes 42-43. This is an advantage under the redemption of stock for payment of death taxes and installment payment of death taxes provisions of the Internal Revenue Code. See I.R.C. §§ 303, 6166 (1985).

80. See I.R.C. § 1014(b)(6) (1985). See also WIS. STAT. § 71.05(1)(9) (1983-84).

of the reclassified property owned by or passing to the surviving donor spouse will receive a stepped up basis.⁸¹ If property has depreciated in value, a step down in basis may be avoided by reclassifying marital property as the individual property of either or both spouses.⁸²

I. Other Estate Planning Aspects

If a will transfers property to individual A, which property is in fact owned by B, and the will transfers other property to B, B has an election. B may retain B's own property and reject the property willed to B, or B may accept the willed property and give B's property to A.⁸³ The estate planner must be careful not to inadvertently create such an equitable election in a will by providing a specific bequest to a third party of an item of marital property or deferred marital property. This problem can be avoided by a contemporaneous marital agreement which classifies items of property specifically bequeathed as the testator's individual property. If a marital agreement cannot be obtained, the testator can avoid the problem by limiting the gift to the testator's interest in the property.

The estate planning goal of many clients will be the maximization of individual property particularly in a second marriage situation. However, all property owned by the spouses is presumed to be marital property.⁸⁴

Items of property can be classified as the individual property of a spouse with a marital agreement, but when the spouses cannot agree, a spouse wishing to maintain that spouse's individual property must maintain adequate records and proof to overcome the presumption of marital property. These records must show how individual property was obtained, such as by inheritance, gift, or before marriage. They must specifically identify the property or its proceeds from the time of acquisition forward. The record keeping involved can be quite simple, as in the case of tangible property which was paid for in full when acquired and kept for the entire period. Conversely, it can be very cumbersome and complex, and at

81. See I.R.C. § 1014(e) (1985).

82. See, e.g., *Crosby v. Commissioner*, 30 T.C.M. (P-H) 61-1554, 61-1555 (1961).

83. See WIS. STAT. § 853.15(1) (1983-84).

84. See 1983 Wis. Laws 186, § 47 (to be codified at WIS. STAT. § 766.31(2)).

times impossible, as in the case of bank or brokerage accounts in which various classifications of assets have been deposited and withdrawn over a period of years.

If marital property is mixed with other property and the other property cannot be traced, the other property is converted into marital property.⁸⁵ Mixing deferred marital property with individual property will cause both the individual and deferred marital property to be classified as deferred marital property unless the individual property can be traced. Certain community property states have developed assumptions which can be used for tracing the separate property component of commingled assets.⁸⁶ However, the Wisconsin Act does not discuss these assumptions.

If a client wishes to maximize and maintain individual property and a marital agreement cannot be reached, the client must reconstruct past transactions immediately. The client cannot wait until after the January 1, 1986 effective date of the Act⁸⁷ as this could result in mixing individual property with deferred marital property.

Other methods which a spouse may use to maximize or protect individual property are also available. First, the spouse may pay all marital obligations first with marital property and then with deferred marital property and pay nonmarital obligations with deferred marital property. Second, the spouse may invest individual property in long-term appreciating assets. The Act provides that income produced from individual property will be marital property⁸⁸ and that appreciation of individual property not resulting from the uncompensated, substantial efforts of either spouse will be individual property.⁸⁹ The appreciating assets should be long-term to avoid any question of the use of "substantial efforts" by the spouse. A spouse does not violate the duty of good faith by managing individual property in a manner which limits, diminishes, or

85. See *id.* (to be codified at WIS. STAT. § 766.63(1)).

86. For a detailed discussion of the tracing assumptions used by the community property states, see W. REPPY & C. SAMUEL, *COMMUNITY PROPERTY IN THE UNITED STATES* 113-30 (2d ed. 1982).

87. See 1983 Wis. Laws 186, § 93.

88. See *id.* § 47 (to be codified at WIS. STAT. § 766.31(4)).

89. See *id.* (to be codified at WIS. STAT. § 766.31(7)(c)).

fails to produce income.⁹⁰ And finally, the spouse may establish residence in a state which is not a community property state.

III. CONCLUSION

While the Wisconsin Marital Property Act will have many effects on estate planning, the main concern will be to classify the assets of the spouses to determine the ownership interests of each spouse. Marital agreements will become a standard estate planning tool to reclassify property, and customized agreements will be used to meet the specific objectives of each married couple. Marital agreements will also be useful for avoiding the inadvertent reclassification of property.

The structure of Wisconsin's property law, corporate law, probate law, and other areas of the law have been altered by the Act. Many legal questions remain unanswered and changes will be made to the Act. Estate planners have been assigned a serious responsibility. They must carefully analyze each client's property and wishes for its disposition. In so doing, they will provide solutions for the undiscovered problems and the unanswered questions.

90. See *id.* (to be codified at WIS. STAT. § 766.15(2)).

APPENDIX A

	<u>Owner of Policy</u>					
	(1) Insured Spouse	(2) Insured Spouse	(3) Insured Spouse	(4) Spouse of Insured	(5) Third Person	(6) Third Person
<u>When Policy Issues</u>	After determination date	Before determination date	Before determination date	Before or after determination date	Before or after determination date	Before or after determination date
<u>Classification of Premium Payments after Determination Date</u>	Any classification	No payments with marital property	At least one payment with marital property	Any classification	No payments with marital property	At least one payment with marital property
<u>Classification of Life Insurance Policy and Proceeds</u>	Marital	Individual property of owner	Mixed*	Individual property of owner	Property of third person (no ownership interest to either spouse)	Mixed*

* If a life insurance policy is classified as mixed property, the marital property portion equals the period after the initial premium with marital property divided by the entire period that the policy is in effect multiplied by the entire proceeds of the policy. The remaining amount of the proceeds is the individual property of the owner.