



WRMarketplace

An AALU Washington Report

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TOPIC: Planning for Incapacity – Waiting Until a Plan is Needed May be too Late.

MARKET TREND: While the risk of disability may be just as or possibly more likely than death for individuals at various ages, many still give their incapacity planning short shrift.

SYNOPSIS: A well-constructed legacy plan should include a comprehensive approach for dealing with possible incapacity, which often involves a revocable living trust, general and health care powers of attorney, a living will, nomination of guardians of the person and estate, a HIPPA authorization, and disability and long-term care insurance. Otherwise, an individual's incapacity can result in prolonged court proceedings to appoint a guardian, emotional distress for the family, the loss of individual privacy, and serious expense.

TAKE AWAYS: Planning for incapacity can be tough, since it requires difficult decisions that many individuals do not want to face. A failure to plan, however, can result in far more trouble for the family and lead to costly (and unwanted) court proceedings. Individuals who implement incapacity plans, though, should keep in mind that they are not "set it and forget it" propositions. Since family dynamics and other circumstances change constantly, incapacity plans should be reviewed and updated annually.

Although estate planning often focuses on what happens after death, a comprehensive legacy plan also addresses planning for possible incapacity during life. Mental or physical incapacity, whether temporary or permanent, can occur at any time from accidental injury or disease, and, with longer life expectancies due to modern medical advances, individual incapacity may last for many years before death. Failure to plan for incapacity now can lead to major problems later, compounding family governance and control issues, particularly when complex assets, like private equity and closely-held business interests, are involved.

NO PLAN? IT'S IN THE COURTS' HANDS

Without incapacity planning, the courts may determine who handles an individual's assets and makes decisions on his behalf. These decisions can range from the management and investment of the individual's assets (including voting control over a company), to where the individual will live, who can have access to the individual, the type of medical treatment the individual will receive, the selection of physicians and day-to-day caretakers, and whether life-prolonging treatments should be administered or withdrawn. Court proceedings for the appointment of a guardian (sometimes referred to as a "conservator") can be expensive and time consuming, particularly if there is a fight over who should serve as the individual's guardian, the expense of which will be paid from the individual's estate. In addition, the individual's financial and other personal information will become part of the (public) court record.

MAKE A PLAN - KEY COMPONENTS

Individuals who implement incapacity plans can generally avoid court guardianship proceedings. A properly constructed plan includes seven interrelated components:

1. A revocable living trust;
2. A general durable power of attorney for property and financial matters;
3. A health care power of attorney;
4. A living will;
5. Nomination for guardians of the person and estate;
6. An authorization to disclose medical information under the Health Insurance Portability and Accountability Act (a "**HIPAA Authorization**"); and
7. Disability and long-term care insurance.

1. **Revocable Living Trust.** A revocable living trust ("**revocable trust**") can serve as a cornerstone of an individual's incapacity planning but only **if the trust is funded.**

In the typical revocable trust, the individual serves as trustee until incapacitated, at which time the successor trustee automatically steps in to manage the trust's assets and use funds for the benefit of the individual without the need for court involvement. A well-crafted revocable trust will include provisions specifically dealing with the individual's incapacity, such as:

- How to determine whether the individual is incapacitated (for example, upon certification of two attending physicians) to obviate the need for a court determination.
- Authorization for expenditures that allow the individual to continue living at home, including remodeling the home, payment of in-home nursing care, and the purchase of specialized medical equipment.
- Authorization to distribute trust funds to support the individual's dependents, such as a spouse, minor or incapacitated children, and extended family, like elderly parents.
- Authorization to engage in sophisticated estate planning using gifts, installment sales, GRATs, and even charitable techniques. Such authority can be particularly important if the individual has created an irrevocable life insurance trust ("ILIT") that requires maintenance such as continuing gifts for the payment of insurance premiums.

If the individual owns an interest in a closely-held business, the revocable trust can provide a succession plan for the management and voting of such interest (particularly critical if it's a controlling interest). The trust also can appoint special trustees or advisors who are familiar with the business to vote the shares or manage the company without giving them control over the individuals' other assets or the distribution of trust funds. In these cases, the trust should be coordinated with company documents, such as buy-sell agreements and changes to the management structure that may be triggered if the individual is permanently incapacitated.

- ✓ **Practice Point.** Some individuals believe that holding assets in joint tenancy will be sufficient for incapacity purposes. While joint tenancy may work for some estate planning purposes, it is a poor substitute for a proper revocable trust. Although the other joint tenant would be able to access financial accounts to pay bills and manage investments, the joint tenant would be unable to sell or mortgage real property without the incapacitated individual's consent, potentially requiring a court-appointed guardian. Joint tenancy also exposes the individual's assets to seizure by the other tenant's creditors.

In addition, the transfer of certain assets into joint tenancy may have gift tax consequences and could disrupt the balance of the individual's legacy plan.

2. **General Durable Power of Attorney.** Closely connected to the revocable trust is the general durable power of attorney ("DPOA") for financial matters. A general DPOA will authorize an agent, selected by the individual, to manage and invest **assets that are not held in a revocable trust**. The document also can authorize the agent to file tax returns, pay bills and expenses, borrow money on behalf of the individual, sell or mortgage real property, apply for government benefits and manage the individual's health, property, and life insurance policies. Other key provisions for a general DPOA include:

- Ensuring the general DPOA is "durable," meaning the power will not terminate if the individual becomes incapacitated. To be "durable," the general DPOA must include specific language. General DPOAs also can be "springing," meaning that the agent does not have the authority unless and until the individual is incapacitated.
 - Authorizing sophisticated estate planning approaches and identifying each specifically so the IRS will recognize them.
 - Authorizing the agent to make intra-family loans and gifts.
 - Specifying the procedures for determining if the individual is incapacitated.
 - Authorizing the agent to change beneficiary designations for life insurance and retirement plans, consistent with the individual's overall legacy plan.
 - Authorizing the agent to vote the stock or interest in a closely-held or other business and to enter into buy-sell and other agreements with respect to the business interest.
- ✓ **Practice Point.** Individuals must carefully consider who should serve as successor trustees under revocable trusts and as agents under general DPOAs. The automatic reaction may be to appoint a spouse, child, other family member, or friend. Depending upon the sophistication required to manage the individual's assets, however, these individuals may not be the best choices. Further, while a bank or trust company can be appointed as successor trustee of the revocable trust, it generally cannot or will not serve as an agent under a general DPOA.

3. **Health Care Power Of Attorney.** A health care power of attorney (“HCPOA,” also referred to as an advance medical directive or health care proxy) grants the individual’s selected agent the authority to make medical decisions. The powers granted to the agent generally include the authority to determine and consent to medical treatments, select and dismiss physicians and other health care providers, and admit the individual into a hospital, nursing home, or assisted living facility. The document can be tailored to meet the individual’s specific wishes, including desires regarding the donation of body parts. This document also should set out guidelines to determine when the individual is incapacitated.
 - ✓ **Practice Point.** Again, individuals must carefully consider who will serve as the agent under a HCPOA. Unlike financial and business matters that can be handled at a distance, a health care agent will need to interact frequently, even daily, with physicians and other health care providers. The agent also will have a duty to check on the individual on a regular basis and oversee his care. These factors dictate appointing someone who lives nearby. Further, if the individual has decided for or against life-prolonging treatments, the individual will need to select an agent who will honor these wishes.
 - ✓ **Practice Point.** Whether for a trustee or agent under a general DPOA or HCPOA, the document should always name a series of successor fiduciaries.
4. **Living Will.** A living will sets out an individual’s wishes regarding end-of-life care and the provision or withholding of life-prolonging treatment. It’s often incorporated into a HCPOA.
 - ✓ **Practice Point.** It is vital that the individual express his desire to continue or terminate extraordinary measures in writing and discuss these wishes with his health care agents and family members. Failure to do so could leave the individual in limbo while family members engage in expensive and lengthy litigation over a treatment plan.
5. **Nomination of Guardian of the Person and Estate.** Unfortunately, not all plans work smoothly – designated general and health care agents may be unable or unwilling to serve, a financial institution may not recognize a general DPOA, or additional protection may be needed from persons attempting to take advantage of the individual’s vulnerability. In such instances, it may be necessary or advisable to have a court-appointed guardian as a back-up plan.

Execution of a nomination of a guardian of the person and estate will give the individual some control over who may be appointed. In some states, it may be possible to incorporate such nominations into the general DPOA and HCPOA.

6. **HIPAA Authorization.** Federal and state legislation restricts access to an individual's medical records without the individual's consent. These laws can make it difficult for successor trustees and agents to obtain medical information that may be needed to implement the incapacity plan. A HIPAA Authorization allows the individual's physicians and other medical care providers to disclose otherwise private (and federally-protected) medical information to the individual's designated agents and successor trustees.
7. **Disability and Long-Term Care Insurance.** Increased life expectancies combined with rising health care costs can deplete many individuals' assets, particularly if the individual requires daily care, leaving little for the surviving spouse or children. Disability and long-term care insurance can help cover the expenses of a nursing home, assisted living facility, or in-home assistance should the individual become incapacitated – costs that are not covered by Medicare. For many individuals, disability and long-term care insurance should be a key component of an incapacity plan as a tool to help preserve the individual's assets. See WRMarketplace No. 2015-29 for a discussion of long-term care insurance.

TAKE-AWAYS

Planning for incapacity can be tough, since it requires difficult decisions that many individuals do not want to face. A failure to plan, however, can result in far more trouble for the family and lead to costly (and unwanted) court proceedings. Individuals who implement incapacity plans, though, should keep in mind that they are not "set it and forget it" propositions. Since family dynamics and other circumstances change constantly, incapacity plans should be reviewed and updated annually.

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