BESSEMER TRUST

A Closer Look

Planning for Incapacity

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In Brief

- **In addition to the disposition of assets at death, your estate plan should address who can make decisions regarding your financial, medical, and other personal affairs in the event that you become temporarily or permanently incapacitated.**
- **While people are living longer than ever before, incapacity later in life is also growing more prevalent, and elder abuse is on the rise.**
- **In this A Closer Look, we review the documents necessary for thorough incapacity planning — the considerations involved in creating them and, importantly, when and how to implement them.**

When most people consider their estate planning, they think of disposing of their assets at death. While that remains central, it is increasingly important to also plan for the management of your financial and personal affairs in the event that you are mentally incapacitated, whether temporarily or permanently.

With medical science enhancing our ability to live longer, but not necessarily better, incapacity is a more prevalent concern, especially toward the end of life. According to the Alzheimer's Association, an estimated 5.8 million Americans suffer from Alzheimer's dementia today, and this number is expected to almost triple by 2050.[1]

The legal documents used to designate others to make decisions for you in the event of a period of mental incapacity are not overly complex. For financial and personal business matters, we recommend a power of attorney and the use of a revocable trust. For healthcare matters, a healthcare proxy, a living will, and a HIPAA[2] release can be used. Each state has its own laws governing these documents, but the power of attorney and healthcare forms tend to be standard and most of the time do not have to be customized (although you will need to make several decisions). When preparing your will, most lawyers will offer to prepare these documents as well.

It can be difficult to determine when a person has reached the level of incapacity where they can no longer make financial decisions for themselves, or to even agree on how that determination should be made. Should doctors be involved? What if family members disagree about whether and how the documents should be used? Clear-cut answers are rare. Elderly people with symptoms of dementia often have moments of lucid thinking and other moments when their decision making is clouded, and they can go in and out of these periods several times each day. Doctors may not even agree, and to make this more complex, the legal standards for measuring capacity may differ depending on what action is taken.

Compounding this difficulty is the fact that financial abuse of the elderly is on the rise. The power of attorney document, in particular, conveys broad financial powers to the designated agent. These powers can be abused if held by the wrong persons. Sadly, in many financial elder abuse situations, a family member or caregiver might be the bad actor.

Having the right documents in place well in advance of any temporary or permanent incapacity can provide invaluable protections for you, ensure your wishes are known and followed, and reduce the burdens placed on your family and loved ones.

[1] *2020 Alzheimer's Disease Facts and Figures,* Alzheimer's & Dementia: The Journal of the Alzheimer's Association.

[2] The Health Insurance Portability and Accountability Act.

Documents for Financial and Personal Business Matters

- **General power of attorney.** One method of providing for management of your assets during incapacity is to have an up-to-date general power of attorney, whereby you, as principal, name someone else as your financial agent (also sometimes called an attorney-in-fact), who is authorized to manage your financial affairs, including paying bills and entering into contracts or other financial arrangements. A general power of attorney may be effective immediately, even while you have full capacity, or it may be effective only if you become incapacitated. When you name an agent under a power of attorney, the agent can essentially step into your shoes and conduct any financial transaction that you could have conducted.

- An **immediately effective power of attorney** gives the financial agent authority to act without proving your incapacity to third persons, such as banks. The advantage of an immediately effective power is that if you do become incapacitated, your financial agent will be spared the requirement of proving your incapacity whenever the power is being exercised. On the other hand, if the power is effective without proof of incapacity, there is greater risk of fraud by a dishonest financial agent, even if you never lose capacity. Of course, if you do not have absolute faith and confidence in the financial agent, then the financial agent should not be given power of attorney in the first place. For a power of attorney that is immediately effective, be sure that the power states that it is durable, meaning that it continues to be valid even after you lose capacity.

- A **springing power of attorney** cannot be exercised until you actually become incapacitated. The advantage of a springing power is that it prevents anyone from exercising any control over your finances and personal affairs unless it is necessary due to your incapacity. The disadvantage is that if you do become incapacitated, the agent may have to prove your incapacity to every third party with whom the agent transacts business on your behalf, which can be cumbersome. If a springing power of attorney is chosen, the document should set forth the type of proof of incapacity that will be sufficient for third parties, certification by one or more physicians or an affidavit from the agent. You do not want to rely upon a court determination of incapacity (See What Happens if You Don't Designate Someone to Make Decisions for You?).

  In addition to the above decision points, most power of attorney forms also allow the following:

  – Designation of multiple agents who can act either separately or together.

  – Designation of successor agents.

  – Allowing the agent to continue to make gifts to your family, including to themselves, or to charities.

- **Revocable trust.** Another option for managing assets during incapacity is to establish a revocable trust to hold your assets. So long as you are living and in good health, you have complete control of the trust, including the ability to manage the assets as trustee and to revoke the trust. The trust can name a successor trustee to take over management of trust property in the event of your incapacity. Often the trust is a better vehicle for asset

What Happens if You Don't Designate Someone to Make Decisions for You?

State law has procedures for a court-appointed guardian or conservator to act if you become incapacitated and can't make decisions for yourself. Typically, someone close to you would petition to ask a court to appoint a guardian (although the petitioner does not have to be the person appointed). The court would then have to find that you are, in fact, unable to make decisions for yourself. The process can include a court-appointed attorney to represent you in the proceeding (called a guardian *ad litem*) and testimony under oath, in a public court proceeding, from your doctors, family members, and others about your mental health.

Sometimes these proceedings are contested. A well-publicized contested proceeding took place in 2014 over the mental health of Donald Sterling, the owner of the Los Angeles Clippers NBA franchise. In that case, Mr. Sterling was adjudicated incompetent, but only after a "battle of the experts" with doctors on each side providing opinions about Mr. Sterling's mental condition. Needless to say, most people would not want to go through such a public process.

management than a power of attorney because the role and responsibilities of a trustee are better defined under state law than for an agent under a power of attorney. In particular, financial institutions usually have an easier time dealing with trustees than an agent under a power of attorney.

Many trust documents define the term incapacity to mean the period after a court has certified the person incompetent or after one or more doctors have certified that the person is no longer capable of making financial decisions. At first thought, this approach can seem sensible because many people would want a doctor or independent party, as opposed to family or friends, to make the medical determination of incapacity. However, requiring doctor involvement can create practical problems. Often a primary care physician needs to bring in a neuro-specialist to make the determination, and that doctor is often unfamiliar with the patient. This can result in the need for a more rigorous mental health examination.

Even if you have a revocable trust, you should also have and keep a general power of attorney because the trustee of the revocable trust only can act with respect to assets that are titled in the name of the trust. The power of attorney, on the other hand, will allow the agent to act for any assets outside of the trust. In addition, the power of attorney has certain powers that are not available to a trustee, such as the ability to deal with social security issues or to sign an individual tax return.

Fiduciary Roles vs. Individual Roles

In thinking about how a power of attorney will work, it is important to distinguish between roles where you act in your individual capacity and other roles where you are a fiduciary. Fiduciary roles include trustees of trusts and other roles specified in trust instruments, such as "trust protector" or "investment direction advisor."

A power of attorney works only for acts that you could take individually and not for fiduciary roles. For example, if you have a revocable trust and are the trustee, the agent under your power of attorney cannot take actions of the trustee. If you can no longer act in a fiduciary role because of a mental disability, the trust instrument itself will usually have provisions that name a successor fiduciary or contain the mechanism to do so.

Documents for Medical and Personal Care Matters

- **Healthcare power of attorney.** A healthcare power of attorney, sometimes called a healthcare proxy, designates a healthcare agent who is authorized to make medical and personal care decisions for you if you cannot make those decisions for yourself. A healthcare power of attorney also designates a person with authority to review and release your protected health information[3] and can set forth any special instructions regarding particular types of care you should or should not receive.
- **HIPAA release.** A HIPAA release grants to designated persons access to your protected health information, so that medical care providers can keep them informed of your condition. Generally, a healthcare agent under a healthcare power of attorney is already entitled to such information, but you may wish others to be kept informed even if they are not decision makers.
- **Life-sustaining and death-delaying treatment.** A living will, sometimes referred to as an advance directive, expresses your wishes regarding the administration or withholding of artificial life support (e.g., nourishment and hydration) where there is no expectation of recovery. In some states, this document is separate from a healthcare power of attorney, and in others, they are included in the same document.
- **Replacement of "stale" documents.** Even if you have previously executed disability planning documents as described above, it would be wise to have them updated every few years because the law in this area is constantly evolving. In addition, because the documents are state specific, you should have documents for each state where you spend a significant amount of time.

[3] Protected health information is information protected from disclosure under the federal HIPAA privacy law, which places strong restrictions on a physician's ability to discuss any aspect of your health with anyone else unless you have granted the individual access to such information.

When Should the Financial Agent Begin Acting? Is a Declaration of Incapacity Necessary?

Once the documents are in place, the focus then turns to those named agents to be on the ready and to know when and how to take on their role. Especially when dealing with financial matters, deciding when to begin to use the power of attorney or to take over as trustee of the revocable trust can be vexing. In most cases, the mental decline of an elderly individual is gradual, and it is hard to know exactly when they can no longer make financial decisions if they have only isolated instances of confusion or delirium. The decision can be made more difficult if it takes away some of the independence of an elder, which could lead to more confusion or stress and possibly make the situation worse. And without good communication in a family, sibling rivalry can be heightened, and other tensions can appear.

In the best-case scenario, the agent, typically a spouse or one or more children, first makes a decision that it is best to be involved in paying bills and reviewing investments. This could start as a "second set of eyes" to watch for problems without taking any decision-making authority from an elderly parent. One of the benefits of the power of attorney is simply the power to request and receive information, such as copies of investment account statements and credit card bills. The next step might be that certain decisions are made jointly with the agent under the power of attorney holding what amounts to a veto power. This gradual process allows third-party providers, such as banks and investment firms, to have time to get to know and work with the agent.

In most cases, and if the right documents are in place, there does not need to be a formal declaration of incapacity. The agent begins to use the power of attorney to make certain decisions, and if a revocable trust is involved, perhaps that same agent can be appointed as a co-trustee to perform similar functions with respect to trust assets. Ultimately, if the grantor of the trust does reach a stage of dementia where he or she really cannot act, then a simple resignation as the trustee should suffice to transfer control of the trust to the existing co-trustee or named successor trustee. Only when the documents are not in order, when there is resistance by the elder, or there is a dispute among the family members or relevant parties as to the level of incapacity does there need to be a formal finding of incompetence.

When there is not total agreement among family members, transparency usually helps alleviate the conflict. In the first instance, it is always helpful if you tell your children that they have been named as agents or successor trustees, and if all children have not been named to act together, to explain the reasons for that. Once the agent or successor trustee begins to act, transparency of the agent's actions to other family members is useful to head off later disputes. Potential areas of conflict include whether a gifting pattern to family members should be continued or altered and which of the agent's own expenses should be covered. We have even seen discussion of compensating the agent or trustee to encourage that person to take the role seriously and to pay for certain expenses necessary to discharge the duties responsibly.

Planning for Incapacity: Earlier Is Better

Of course, we all hope that we will never have to grapple with incapacity of any kind, but it's impossible to predict if and when it will happen. If it does, having the right documents and prepared agents and trustees in place can help ensure that critical decisions related to your financial and personal welfare are made in your best interests and in accordance with your wishes.

If you have any questions about planning for incapacity, or you would like to explore this subject further, please reach out to your client advisor.

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