I ESTATE PLANNING FOR INCAPACITY OF THE CLIENT

A. Planning for Health Care Decisions

1. Powers of Attorney

a. Durable Power of Attorney. The Durable Power of Attorney is a written instrument under which the grantor of the power (the "principal") confers upon one or more attorneys in fact or agents the right to handle the principal's financial affairs. Durable Powers of Attorney are governed by Florida Statute Section 709.08.

(i) Execution. The Durable Power of Attorney must be in writing, must be executed with the same formalities required for the conveyance of real property under Florida law (i.e., two witnesses and a notary), and must contain the words: "This durable power of attorney is not affected by subsequent incapacity of the principal to 30except as provided in Section 709.08, Florida Statutes," or similar wording.

(ii) Who May Serve. The attorney in fact or agent appointed under the Durable Power of Attorney must be either (i) a natural person eighteen years of age or older and of sound mind, or (ii) a financial institution as defined in

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Florida Statutes Chapter 655 that has trust powers, a place of business in Florida, and is authorized to conduct trust business in Florida.

(iii) Exercisability. The Durable Power of Attorney under Florida law is generally immediately exercisable, i.e., it can be exercised by the attorney in fact regardless of whether or not the principal is incapacitated. However, under an amendment passed during the 2001 legislative session and signed by Governor Bush on June 15, 2001, the Durable Power of Attorney may be conditioned upon the principal's lack of capacity to manage property. Laws of Florida, Chapter 2001-241. This is called a "springing power of attorney" which many other states have had for years but Florida has not. The new law change is effective January 1, 2002. The law is not clear whether the durable power of attorney must be executed on or after January 1, 2002, to take advantage of the new law change. Presumably, powers of attorney can be executed now to provide that with respect to any exercise on or after January 1, 2002, the incapacity of the principal will be required before the power can be exercised.

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It is strongly recommended that clients be made aware of the new law change and that they be given the chance to amend their powers of attorney if they wish to take advantage of the new law. Durable Powers of Attorney are in many ways the most dangerous documents prepared by estate planners for their clients, primarily because they have not in the past required incapacity to be exercisable. Most clients sign Durable Powers of Attorney under the belief that it is to be used only in the event of their incapacity.

If the effectiveness of a Durable Power of Attorney is conditioned on the incapacity of the principal, then the attorney-in-fact must obtain and produce an affidavit of incapacity executed by a licensed physician. The physician executing the affidavit must be the primary physician who has responsibility for the treatment and care of the principal. The affidavit executed by the physician must state where the physician is licensed to practice medicine, that the physician is the primary physician who has responsibility for the treatment and care of the principal, and that the physician believes that the principal lacks the capacity to manage property as defined in Florida Statutes Section

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744.102(10)(a). The affidavit may, but need not, be in the following form:

STATE OF_______________
COUNTY OF_______________

Before me, the undersigned authority, personally appeared (name of physician), Affiant, who swore or affirmed that:

1. Affiant is a physician licensed to practice medicine in (name of state, territory, or foreign country) .

2. Affiant is the primary physician who has responsibility for the treatment and care of (principal's name) .

3. To the best of Affiant's knowledge after reasonable inquiry, Affiant believes that the principal lacks the capacity to manage property, including taking those actions necessary to obtain, administer, and dispose of real and personal property, intangible property, business property, benefits, and income.

____
(Affiant)

Sworn to (or affirmed) and subscribed before me this (day of) (month) , (year) , by (name of person making statement)

(Signature of Notary Public-State of Florida)
(Print, Type, or Stamp Commissioned Name of Notary Public)
Personally Known OR Produced Identification
(Type of Identification Produced)

A physician who makes a determination of incapacity to

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manage property is not subject to criminal prosecution or civil liability and is not considered to have engaged in unprofessional conduct as a result of making such determination, unless it is shown by a preponderance of the evidence that the physician making the determination did not comply in good faith with the provisions of the statute. A third party may not rely on the authority granted in a durable power of attorney conditioned on the principal's lack of capacity if the affidavit is more than six months old when the power of attorney is first presented to the third party.

(iv) Multiple Attorneys in Fact. Unless the durable power of attorney provides otherwise, if a durable power of attorney is vested jointly in two attorneys in fact by the same instrument, concurrence of both is required on all acts in the exercise of the power. If a durable power of attorney is vested jointly in three or more attorneys in fact by the same instrument, concurrence of a majority is required in all acts in the exercise of the power. Unless the durable power of attorney provides otherwise, all authority vested in multiple attorneys in fact may be exercised by the one or more that remain after the death, resignation, or incapacity of one

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or more of the multiple attorneys in fact.

(v) Dissenting Attorney in Fact. An attorney in fact who has not concurred in the exercise of authority is not liable to the principal or any other person for the consequences of the exercise. A dissenting attorney in fact is not liable for the consequences of an act in which the attorney in fact joins at the direction of the majority of the joint attorneys in fact if the attorney in fact expresses such dissent in writing to any of the other joint attorneys in fact at or before the time of the joinder. However, if the attorney in fact has accepted appointment either expressly in writing or by acting under the power, this does not excuse the attorney in fact from liability for failure either to participate in the administration of assets subject to the power or for failure to attempt to prevent a breach of fiduciary obligations thereunder.

(vi) Third Party Reliance. Third parties who act in reliance upon the authority granted to the attorney in fact under the durable power of attorney and in accordance with the instructions of the attorney in fact must be held harmless by the principal from any loss suffered or

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liability incurred as a result of actions taken prior to receipt of written notice. A person who acts in good faith upon any representation, direction, decision, or act of the attorney in fact is not liable to the principal or the principal's estate, beneficiaries, or joint owners for those acts.

The third party may, but need not, require the attorney-in-fact to execute an affidavit stating that there has been no revocation, partial or complete termination, or suspension of the durable power of attorney at the time the durable power of attorney is exercised.

The durable power of attorney may provide that the attorney-in-fact is not liable for acts or decisions taken in good faith and under the terms of the durable power of attorney.

(vii) Property Subject to Durable Power of Attorney. Unless otherwise stated in the instrument, the durable power of attorney applies to any interest in property owned by the principal, including without limitation the principal’s interest in all real property, including homestead; all personal property, tangible or intangible; all

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property held at any type of joint tenancy, including tenancy in common, joint tenancy with right of survivorship, or tenancy by the entirety; all property over which the principal holds a general or limited power of appointment; all choses in action; all other contractual or statutory rights or elections, including but not limited to probate or similar proceedings.

(viii) Limitations on Powers of the Attorney-in-fact. Except as otherwise limited under applicable law or the instrument, the attorney-in-fact has full power to perform without prior court approval every act authorized and specifically enumerated in the instrument, including the ability to execute stock powers and to convey or mortgage homestead property. If the principal is married, the spouse of the principal will be required for any such conveyance or encumbrance, but if the spouse is the attorney-in-fact, then this means that only the spouse’s signature is necessary.

The attorney-in-fact may not under any circumstances perform duties under a contract requiring the personal services of the principal; make an affidavit as to personal

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knowledge of the principal; vote in a public election for the principal; execute or revoke a will or codicil for the principal; or exercise powers and authority granted the principal as trustee or as a court-appointed judiciary. Florida Statutes § 709.08(7)(b).

The attorney-in-fact may not create, amend, modify, or revoke a living trust or transfer assets to an existing trust created by the principal unless expressly authorized by the power of attorney.

The attorney-in-fact may not make gifts under the power of attorney unless the power is specified in the instrument. Johnson v. Fraccacreta, 348 So.2d 570 (Fla. 4th DCA 1977).

(ix) Self Gifting. If the power to make gifts is given under the power of attorney, care must be taken to insure that the ability by the attorney-in-fact to make gifts to himself or herself is restricted so as to avoid the attorney-in-fact from being considered as having a general power of appointment that would result in the principal's assets being included in the attorney-in-fact's estate if the attorney-in-fact dies before the principal.

(x) Health Care Decisions. The attorney-in-fact can be given the power to make health care decisions for the principal. However, this is typically done using a separate health-care power of attorney.

(xi) <u>Nondelegability.</u> The durable power of attorney is nondelegable.

(xii) <u>Revocation, Suspension or Termination.</u> The power of attorney is terminated immediately upon the death of the principal. It is also terminated if the principal is adjudicated totally or partially incapacitated by a court of competent jurisdiction, unless the court determines that certain authority granted by the durable power of attorney is to remain exercisable by the attorney-in-fact.

If any person or entity initiates court proceedings to determine the principal's incapacity, the authority granted under the power of attorney is suspended until the petition is dismissed or withdrawn. Notice of the petition must be served on the attorney-in-fact.

It is more difficult for the principal to revoke a durable power of attorney than it is to create one. This is one good reason why having a springing power of attorney, rather than one that is immediately exercisable, may be a good

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idea, or if a power of attorney that is immediately exercisable is desired, having the power of attorney provide that only the original is effective, and the original be held in a safe place, such as the attorney's safe. If only the original is effective, then physical destruction of the instrument will effectively revoke it. Otherwise, the provisions of Florida Statutes Section 709.08(5) must be complied with. This provision requires that formal notice be served upon the attorney-in-fact and on every third party who may be called upon to rely upon the power of attorney (i.e., every financial institution or other custodian of the principal's property). Formal notice means certified mail with return receipt required or personal delivery as provided for service of process. Personal delivery of notice to a financial institution requires service upon an officer or manager at both the financial institution's principal place of business in Florida and the office where the applicable account has been canceled or administered. Except for court orders, a third party served with notice must be given 14 calendar days after service to act upon the notice.

If the principal owns real property, then the revocation

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instrument needs to be recorded on the public records of the county where the property is located.

All of the above means that revocation of a power of attorney can be expensive and cumbersome, and it may not be possible to do so where time is of the essence.

(xiii) Damages and Costs. If a third party refuses unreasonably to permit the attorney-in-fact to exercise a power under the power of attorney, and the attorney-in-fact has to bring a court action to enforce it, and prevails in the court action, the attorney-in-fact has the ability to receive damages and costs, including reasonable attorneys' fees. Conversely, if the third party prevails in court, the third party has the right to receive damages and costs from the attorney-in-fact. This provision was added to the statute in 1995, and only applies to powers of attorney executed on or after October 1, 1995.

b. Health Care Surrogate.

(i) Health Care Surrogate Designations (also known as Health Care Powers of Attorney) are governed under Florida Statutes Sections 765.201 - 765.205. A health care surrogate may be designated by written document, signed

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by the principal in the presence of two subscribing adult witnesses (or if the principal is unable to sign, the principal may direct that another person sign the principal's name). An exact copy must be provided to the surrogate. The person designated as surrogate shall not act as a witness. At least one person acting as a witness must not be either the principal's spouse or blood relative. The document may also designate an alternate surrogate to act of the primary surrogate named is unable to do so. If neither the designated surrogate nor alternate is able or willing to make health care decisions, the health care facility may seek appointment of a proxy.

(ii) A suggested form of designation is set forth in F.S. 765.203, and reads as follows:

Name:_____(Last)_____(First)_____(Middle Initial)_____

In the event that I have been determined to be incapacitated to provide informed consent for medical treatment and surgical and diagnostic procedures, I wish to designate as my surrogate for health care decisions:

Name:

Address:

Phone:

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If my surrogate is unwilling or unable to perform his or her duties, I wish to designate as my alternate surrogate:

Name:

Address:
Phone:

I fully understand that this designation will permit my designee to make health care decisions, except for anatomical gifts, unless I have executed an anatomical gift declaration pursuant to law, and to provide, withhold, or withdraw consent on my behalf; to apply for public benefits to defray the cost of health care; and to authorize my admission to or transfer from a health care facility.
Additional instructions (optional):

I further affirm that this designation is not being made as a condition of treatment or admission to a health care facility. I will notify and send a copy of this document to the following persons other than my surrogate, so they may know who my surrogate is.

//Signature, witnesses, notary//

(iii) Determining Incapacity. The principal is presumed to be capable of making his own health care decisions, unless he is determined to be incapacitated by the attending physician and the determination is confirmed by an another physician. If the second physician agrees, the

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health care facility enters both physicians' evaluations in the principal's clinical record and notifies the surrogate (if there is one) in writing. At that point the surrogate has the authority to make medical decisions for the client, and continues to have such authority until there is a determination that the principal has regained capacity.

A determination that a principal lacks capacity to make health care decisions shall not be construed as a finding that a principal lacks capacity for any other purpose.

(iv) Authority of the Surrogate. The surrogate has the authority and responsibility to act and make health care decisions for the principal during the principal's incapacity, in accordance with the principal's instructions, unless such authority has been expressly limited; to consult expeditiously with appropriate health care providers to provide informed consent, and make only health care decisions that he or she believes the principal would have made under the circumstances; to provide written consent to medical procedures; to be provided access to appropriate clinical records; to apply for public benefits and have access to financial information to the extent required to make such

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application; and to authorize the release of information. Absent court order, the surrogate continues to make health care decisions for the principal after appointment of a guardian.

The surrogate may not consent to abortion, sterilization, electroshock therapy, psychosurgery, certain experimental treatments, or voluntary admission to a mental health facility, nor may the surrogate consent to withholding or withdrawing life-prolonging procedures from a pregnant patient prior to viability.

(v) Review of Surrogate’s Decision. The patient's family, the health care facility, or the attending physician, or any other interested person who may reasonably be expected to be directly affected by the surrogate or proxy's decision concerning any health care decision may seek expedited judicial intervention pursuant to rule 5.900 of the Florida Probate Rules, if that person believes:

(1) The surrogate or proxy's decision is not in accord with the patient's known desires or the provisions of this chapter;

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(2) The advance directive is ambiguous, or the patient has changed his or her mind after execution of the advance directive;

(3) The surrogate or proxy was improperly designated or appointed, or the designation of the surrogate is no longer effective or has been revoked;

(4) The surrogate or proxy has failed to discharge duties, or incapacity or illness renders the surrogate or proxy incapable of discharging duties;

(5) The surrogate or proxy has abused powers; or

(6) The patient has sufficient capacity to make his or her own health care decisions.

(vi) Termination of Surrogate Designation. A surrogate designation may be amended or revoked at any time by a competent principal either in writing, by physical destruction by or at the direction of the principal, orally, or by later executing a different designation instrument. Unless otherwise provided in the instrument, divorce will

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revoke the designation of the former spouse as surrogate. Any amendment or revocation will be effective when it is communicated to the surrogate, health care provider, or health care facility. No civil or criminal liability shall be imposed upon any person for a failure to act upon an amendment or revocation unless that person has actual knowledge of such amendment or revocation.

(c) Living Will. The Living Will is a declaration that a person's desire that life-prolonging procedures be provided, withheld, or withdrawn in the event that one or more of three specified conditions take place. Living Wills are governed by Florida Statutes Sections 765.301-765.309.

A Living Will may be made by any competent adult at any time, and direct the providing, withholding or withdrawal of life-prolonging procedures in the event such person suffers from a terminal condition, has an end-stage condition, or is in a persistent vegetative state. The term "terminal condition" means a condition caused by injury, disease, or illness from which there is no reasonable medical probability of recovery and which, without treatment, can be expected to

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cause death. The term "persistent vegetative state" means a permanent and irreversible condition of unconsciousness in which there is the absence of voluntary action or cognitive behavior of any kind, and an inability to communicate or interact purposefully with the environment. The term “end-stage condition” means a condition that is caused by injury, disease, or illness which has resulted in severe and permanent deterioration, indicated by incapacity and complete physical dependency, and for which, to a reasonable degree of medical certainty, treatment of the irreversible condition would be medically ineffective. The language regarding “end-stage condition” was added in 1999 and is effective for Living Wills dated on or after October 1, 1999. Clients with Living Wills dated before this date may wish to amend and re-execute their Living Wills to take advantage of the new law changes.

A Living Will must be signed by the principal in the presence of two subscribing witnesses, one of whom is neither a spouse nor a blood relative of the principal. If the principal is physically unable to sign the Living Will, one of the witnesses must subscribe the principal's signature in the principal's presence and at the principal's direction.

It may be revoked by the same means as apply to the Health Care Surrogate Designation.

Withholding or withdrawal of life-prolonging procedures from the patient in accordance with the statute does not constitute a suicide under the law or for life insurance purposes.

The suggested form of the Living Will may, but need not, be as follows:

> Declaration made this _____ day of _____, (year) , I, __________, willfully and voluntarily make known my desire that my dying not be artificially prolonged under the circumstances set forth below, and I do hereby declare that, if at any time I am incapacitated and
>
> (initial) I have a terminal condition
>
> or (initial) I have an end-stage condition
>
> or (initial) I am in a persistent vegetative state
>
> and if my attending or treating physician and another consulting physician have determined that there is no reasonable medical probability of my recovery from such condition, I direct that life-prolonging procedures be withheld or withdrawn when the application of such procedures would serve only to prolong artificially the process of dying, and that I be permitted to die naturally with only the administration of medication or the performance of

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any medical procedure deemed necessary to provide me with comfort care or to alleviate pain.

It is my intention that this declaration be honored by my family and physician as the final expression of my legal right to refuse medical or surgical treatment and to accept the consequences for such refusal.

In the event that I have been determined to be unable to provide express and informed consent regarding the withholding, withdrawal, or continuation of life-prolonging procedures, I wish to designate, as my surrogate to carry out the provisions of this declaration:

Name:

Address:

Phone:

I understand the full import of this declaration, and I am emotionally and mentally competent to make this declaration.
Additional Instructions (optional):

//Signature, witnesses, notary//

(d) Preneed Guardian Designations. The client may designate in writing those persons whom he or she desires to be appointed as guardians for themselves or for their minor children in the event of incapacity. Florida Statutes Sections 744.3045 and 3046.

B. Avoiding Probate: Predisability Planning Avenues

1. Use of Revocable Trusts. A Living Trust is a

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revocable trust establish by the client during his or her lifetime. It is also known by such names as a Revocable Trust, an Inter Vivos Trust, and a "Loving" Trust. A Living Trust offers two major advantages:

- Avoidance of guardianship in the event of incapacity
- Avoidance of probate on death

The client typically serves as the initial Trustee of the Trust and has full management control of the trust assets during his or her lifetime just as though the client owned them individually. During the client's lifetime, the trust assets are considered as owned by the client for income tax purposes, and no trust income tax return is required. In the event of the client's death or incapacity, the person or persons nominated by the client would take over management of the Trust assets as successor Trustee(s), thereby avoiding the need to appoint a guardian with respect to such assets.

Upon the client's death, the assets held in the Trust will be distributed to the beneficiaries or held in trust for them as directed without being subject to the probate

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process.

It is important to remember that to avoid probate, **assets must be titled to the Living Trust during the client's lifetime**. Any assets that have not been titled into the Trust and do not otherwise pass outside of probate will be distributed according to the Will and will be subject to probate.

Sadly, too often people have invested a lot of money in a Living Trust, but failed to title their assets in the Trust during their lifetime. To prevent this, planners need to either give all clients detailed instructions on titling assets into their Trusts or assist in retitling assets.

A Living Trust is not the only way to avoid probate. There are many other mechanisms available to avoid probate, including joint tenancy, beneficiary designations and transfers with retained life estates. Each of them has its own benefits and disadvantages.

Any property that one owns as joint tenants with right of survivorship with anyone, or a tenants by the entireties with one's spouse, will pass outright to the surviving co-owner on

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death without going through probate. However, there are many possible problems with joint tenancies. If a client makes a child a co-owner and later desires to sell the property, then the child's consent will be needed to do so. In addition, if the child has creditor problems, then the creditor may have the ability to place a lien on and foreclose upon the child's interest in the property. Not a happy result!

Property that the client co-owns as tenants in common will be subject to probate upon death.

Beneficiary designations have traditionally been available with life insurance, IRA's and pension plans and bank accounts ("Totten trusts" and "pay-on-death (POD) accounts"). In 1994, Florida adopted the Uniform Transfer on Death Securities Registration Act (Chapter 711, Florida Statutes) which permits beneficiary designations on stock and bond certificates and brokerage accounts. The client simply names the person or persons who are to receive the property on a beneficiary designation form, and upon death, the property or insurance proceeds pass outright to the beneficiaries named. So long as the client doesn't name his or her estate as beneficiary (a common mistake), probate is avoided.

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Because beneficiary designations can generally be changed without the beneficiary's consent, the beneficiary has no rights to the property during his or her lifetime, this method is preferable to a joint tenancy. Unfortunately, beneficiary designations are not very flexible, in that the client generally limited to naming specific individuals as beneficiaries, for example, 50% to Child A and 50% to Child B. If Child B predeceases the client, then the default language on many beneficiary designation forms provides that 100% would pass to Child A, even if Child B has children of his or her own. This can be avoided by adding the abbreviation “LDPS” (lineal descendants per stirpes), which is authorized under the Florida Statutes, but the financial institution may not want to take on the responsibility of trying to figure out who these persons may be.

Probate may be avoided on real estate by deeding the property from the client to the client for life, remainder to the children. This method has several problems. First, there will be a taxable gift not covered by the $10,000 annual exclusion to the extent of the actuarial value of the remainder interest at the time of the deed, which may result

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in gift taxes being payable. Second, while the client retains the right to possess and live on the property during lifetime, there are certain rights given the remainder beneficiaries regarding a duty not to commit waste, etc., with which the client may be uncomfortable. Third, the joinder of the children will be required to sell the property. Many of these problems may be solved, however, by means of an enhanced life estate deed (also known as a “Ladybird” deed), under which the client reserves in the deed the right to change and/or delete the remainder beneficiaries at any time and to sell the property without the consent of the remainder beneficiaries. At least one title company has blessed this type of deed for title insurance purposes.

While other probate techniques are available, a Living Trust is generally the only probate avoidance device that permits sophisticated tax planning, flexibility in disposition instructions, and establishment of protective trusts for children and grandchildren.

Comparison Chart

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	Avoids Probate	Avoids guardianship on incapacity	Avoids possible gift on creation	Flexible	Avoids Co-Ownership Problems	Permits Estate Tax Planning
Will	No	No	Yes	Yes	Yes	Yes
Joint Tenancy	Yes (first death only)	No	No	No	No	No
Retained Life Estate	Yes	No	No	No	No	No
Beneficiary Designations	Yes	No	Yes	No	Yes	No
Living Trust	**Yes**	**Yes**	**Yes**	**Yes**	**Yes**	**Yes**

b. Titling Assets in Living Trusts

(i) In General. Proper titling of assets into a Living Trust generally should follow the following format: "John Smith, as Trustee of the John Smith Living Trust dated January 1, 2001". Abbreviations are sometimes used, such as "John Smith, TTE U/T/D 1/1/01". U/T/D means "under

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trust dated."

(ii) Homestead and other Real Property. Care must be taken with respect to titling homestead and other real property into Living Trusts, and client should be made aware of the possible disadvantages of titling their homestead into a Trust. Specific concerns are as follows:

(a) Trustee Powers. The deed should confer on the trustee the power and authority either to protect, conserve and to sell, or to lease, or to encumber, or otherwise to manage and dispose of the real property described. Florida Statutes Section 689.071.

(b) Title insurance. Consideration should be given to obtaining a rider to the existing title insurance or to a new title insurance policy. Don't use a quitclaim deed. A general warranty deed may permit preservation of title insurance benefits. See Jonathan Rivin and Thomas J. Stikker, Title Insurance for Estate Planning Transfers, *Probate & Property,* May/June 1998.

(c) Due on sale clause. 12 U.S.C. 1701j-3 prohibits the exercise of a due-on-sale clause with respect to a real property loan secured by a lien on residential real property containing less than five dwelling units (including a lien on the stock allocated to a dwelling unit in a cooperative housing corporation, or on a residential manufactured home), upon a transfer into an inter vivos trust in which the borrower is and remains a beneficiary and which does not relate to a transfer of rights of occupancy in the property. Otherwise, get a waiver of due-on-sale clause before making any estate planning transfer of mortgaged property.

(d) Property Tax Exemption . The $25,000 property tax exemption applies to a home to which an eligible Florida resident has "legal *or equitable* title." Florida Constitution, Article VII, Section 6. This includes a residence held in a Living Trust during the Grantor's lifetime. Atty. Gen. Op. 90-070, August 22, 1990.

(e) Creditor Protection. However, the homestead protection from forced sale does not necessarily apply to Living Trust property. Florida Constitution, Article X, Section 4 only exempts homestead property that is owned by a *natural* I*person.* See also *Elmowitz v. Zimmerman*, 647 So. 2d

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1064 (Fla. 3rd DCA 1994). is is a hotly contested issue among planners. Nevertheless, with respect to beneficiaries after the Grantor's death, if the beneficiaries of a revocable trust would otherwise be entitled to the inurement of the homestead exemption from forced sale (i.e., if they are "heirs" and the homestead would have otherwise passed to them directly by devise or descent), the property is not subject to creditors' claims. *HCA Gulf Coast Hospital v. Estate of Downing*, 594 So.2d 774 (Fla. 1st DCA 1992).

(f) Medicaid. If Medicaid qualification is a concern, then a Medicaid planning specialist should be consulted prior to any transfer to avoid triggering the look-back rules. State rules differ.

2. Use of Irrevocable Trusts

a. Irrevocable Life Insurance Trusts

(1) Life insurance proceeds are not subject to probate unless made payable to the estate of the insured. They can be made payable to a Living Trust by beneficiary designation. Probate avoidance is also possible by directly making the beneficiary the Trustee of a Trust established under the Last Will and Testament of the insured,

if a Living Trust is not used.

(2) To avoid potential estate taxes where this is a concern, an Irrevocable Life Insurance Trust should be considered. The Trust will need to be both the owner and the beneficiary of the policy.

b. Irrevocable Gift Trusts, Special Needs Trusts and Lifetime QTIP Trusts. Assets held in these trusts will not be subject to probate upon the death of the grantor or the beneficiary.

C. Advising the Dying Client

1. Retirement Plans and IRA's

a. Beneficiary Designations - Planning for Disclaimer. The typical beneficiary designation used by the author with “nuclear” families is to have the spouse be the Primary Beneficiary with the bypass trust under the account owner’s Living Trust be the Contingent Beneficiary. If no Living Trust is used, the children may be designated as Contingent Beneficiaries. This allows the surviving spouse to decide after the account owner’s death whether to roll over the account into an IRA of his or her own to take advantage of the decreased minimum distributions, or to disclaim all or a portion of the account for estate tax purposes. Great care must be taken to ensure proper and timely execution and recording of any disclaimer.

b. Get Out of Bad Plans! There are actually two sets of distribution rules that apply to any retirement plan account - the IRS rules under the Section 401(a)(9) regulations and the plan document. Many employer-sponsored retirement plans do not offer all of the options permitted under the tax laws. For example, the plan may require a lump sum distribution of the account assets unless left to a spouse. Therefore, review any plan documents and consider rolling plan assets of any "bad plans" into an IRA with appropriate beneficiary designations to avoid possible loss of income tax deferral.

c. Make a Distribution? Consider the client's likely marginal income tax rates this year and determine whether or not to make a retirement plan/IRA distribution in excess of the minimum required amount. Although deferral is usually best, taxes may be saved if the current marginal income tax rates is low and/or estate taxes may be saved because of payment of the income tax.

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2. Life Insurance and Annuities. Beneficiary designations for life insurance policies and any variable or other annuities should be reviewed and modified as necessary.

3. Estate Tax Planning

a. Private Annuities and Self-Canceling Installment Notes. If estate taxes are a concern and the client has a terminal illness or condition that makes it likely that he or she will die significantly before the statistical average but does not disqualify him or her from using the IRS actuarial tables, strongly consider a private annuity or self canceling installment note. For example, if a 60 year old client makes a private annuity sale of $1,000,000 of assets in September 2001 when the applicable IRS interest rate is 5.8%, then the annual payment under the annuity will be only about $90,700. If the client dies at age 62 after receiving only two payments, then $1,000,000 less $181,400, or $818,600, will have been removed from his or her estate for estate tax purposes.

Under Treas. Regs. Section 1.7520-3(b)(3), the standard mortality tables cannot be used for the “terminally ill.” If the client is known to have an incurable illness or other deteriorating physical condition, he or she is considered terminally ill if there is at least a 50 percent probability that the individual will die within 1 year. However, if the client survives for eighteen months or longer after the date of the transaction, that individual shall be presumed to have not been terminally ill at the time of the transaction unless the contrary is established by clear and convincing evidence.

Get a letter from the physician at the time of the transaction indicating that there is a less than 50 percent probability that the client will die within 1 year.

b. Exercise Powers of Appointment. Review any legal instruments under which the client has a power of appointment and consider whether to exercise it. Typically this is done by a codicil to the client's Last Will and Testament.

c. Family Limited Partnerships

(i) If the estate is large enough that estate taxes are still a concern after using the applicable exemption amount and other available techniques, consider a Family Limited Partnership. While "deathbed partnerships" are

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frowned upon by the IRS, they have withstood court challenge. See, e.g. *Church v. United States*, KTC 2000-52 (W.D.Tex. 2000), affirmed by the Fifth Circuit in an unpublished opinion in 2001.

(ii) Make sure that any General Partner interest is owned in the client's Living Trust (if any), and that the appropriate Certificate of Amendment is filed with the state to reflect this, to avoid probate of the partnership interest.

(iii) To ensure that a valuation discount on any Limited Partner interests owned by General Partner, the client should not control the Partnership. Transfer any General Partner interests or stock in any corporation that owns General Partner interests to the junior family members prior to death, if the client permits.

3. Income Tax Planning

a. <u>Exercise Replacement Power.</u> If the client has established any irrevocable trusts during his or her lifetime, check to see if the trust instrument provides that the client has a power to substitute trust assets with other assets of equal value in a nonfiduciary capacity. This is a

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grantor trust power typically given to make the trust a "defective" grantor trust under Internal Revenue Code Section 675. If this power exists, replace any trust assets that have a low income tax basis with cash or high basis assets so that these assets can receive an step-up in basis under Internal Revenue Code Section 1014. Transactions between a grantor and his or her grantor trust are nonrecognition events under Rev. Rul. 85-13.

b. Consider a Lifetime QTIP Trust. Use of a Lifetime QTIP Trust may allow avoidance of Section 1014(e), which denies a step-up in basis if the decedent acquires property within one year before death and the property passes at the decedent's death back to the original donor. The question is whether and to what extent this section applies if the property passes instead to a trust for the benefit of the donor.

There are no regulations on this issue, but the IRS has ruled privately that where, on the donee's death, the property passed back to the donor in a trust that gave a lifetime income interest, only the actuarial value of the life income interest would be subject to Section 1014(e), and the

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remainder would receive a full step-up in basis. PLR 9026036 (partially reversed in PLR 9321050, but on an unrelated issue).

A full step-up in basis may be available when the donor receiving the assets back as the beneficiary of a trust has no interest in the trust capable of actuarial valuation. Ideally, the trust would be structured so that there is an independent trustee with sole and absolute discretion over distributions.

For a discussion of the potential benefits of Lifetime QTIP Trusts, see James F. Gulecas, "Drafting the Lifetime QTIP Trust (with Sample Provisions)," *Practical Tax Lawyer*, Spring, 1999.

4. Transfer Assets. Autos, boats, and other tangible personal items with legal title in the client’s name can be far more easily transferred to the client’s family members during lifetime than at death, assuming that they are not jointly titled or held in a trust. The psychological impact on the client should be weighed against the benefits of this, however.

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