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BASIC ESTATE PLANNING DOCUMENTS

DURABLE POWER OF ATTORNEY

It has always been possible to sign a Power of Attorney. It would allow an individual to authorize someone else to manage their affairs. However, the power became void if the grantor of the power either died or became incompetent. Thus, at the very time one wished a power of attorney to be effective (at incapacity), it became useless. The reasoning was that the power could only be effective so long as the grantor of the power had the ability to revoke it. Obviously, with death, the ability to revoke ended, but likewise with incapacity, the ability to revoke the power ended when you no longer had the mental capacity to make that choice.

Thus, we had a "catch 22", in that the very moment most people wanted a power to be effective, that is, at incapacity, the power was automatically revoked.

Several years ago, a new law was passed, allowing for the creation of a durable power of attorney. This power continued to terminate upon the death of the principal, but would remain in full force and effect during any incapacity. This is a tremendous improvement, and gives us a "window of opportunity" in estate planning, particularly in the context of planning for nursing home costs.

What is a durable power of attorney?

A durable power of attorney is a written document in which you, as the principal, designate someone you trust, such as your spouse, another family member, a friend or a professional (or any combination) as your attorney-in-fact.

Your attorney-in-fact is authorized to perform certain acts on your behalf. You may give as much or as little power to your attorney-in-fact as you desire. Generally, a durable power of attorney is very broad, intending to allow the attorney-in-fact to do

anything and everything necessary to fully manage your affairs.

Your attorney-in-fact is NOT your lawyer, unless you specifically choose him. The phrase, attorney-in-fact, is simply the name we give to the person designated in the power to handle the principal's affairs.

Not all powers of attorney are durable. If the power is not durable, it is an "old" style power, and will automatically be revoked when you become disabled. To make a power a durable power, you need only add a sentence, such as

This power of attorney shall not be affected by the subsequent disability or incapacity of the principal.

The powers you give your attorney-in-fact will be in effect the moment the document is signed. For this reason, care should be taken in the whereabouts of the document itself. Generally, you want to retain physical control of the power of attorney until such time as it is needed.

What happens if you do not have a durable power of attorney

If you become legally incompetent, and have not previously executed a durable power of attorney, in order for anyone to act on your behalf, they must be appointed by the probate court, to be your conservator or guardian. The court appointed fiduciary may be, but is not necessarily, the competent spouse.

Once a guardian or conservator is appointed, he will be subject to the jurisdiction of the probate court. He will not, in most instances, be able to sell, transfer or mortgage any assets without first obtaining court approval. This is important in many circumstances, particularly in Medicaid planning (a request by a guardian or conservator to transfer assets so as to become eligible for Medicaid will be opposed by the State, on the grounds of making oneself indigent so as to receive state benefits, and such a request will not be granted by the Court).

Additional problems with court appointment include time delays and expenses (for legal fees, court filing fees and a surety bond, if necessary). Furthermore, the conservator or guardian must file periodic accounts with the probate court, and these accounts will be open to public scrutiny. Anyone who wants to can go to probate court and examine the files.

Who is the attorney-in-fact?

The attorney-in-fact is a fiduciary. The term "attorney-in-fact" is a term of art which does not mean your lawyer unless he is the person you specify in the document. However, your attorney-in-fact must be someone who will act in your best interest. He is required to account to you for all funds or other assets in his possession, and he is liable to you for any improper actions taken, as measured against the duty of care imposed on fiduciaries generally.

When should you draft a durable power of attorney?

The best time to consider implementing this document is now, while you are competent and have absolutely no reason to delegate your financial affairs to another person. Now is the time to address your estate planning needs, both those that benefit

you while you are alive, and those that benefit your family at your death.

Must a third party (such as a bank) honor a power of attorney?

No. No third party is required to accept a power of attorney. However, it is usually acceptable, although varying degrees of reluctance will be encountered. The reason is the ever present possibility that the principal (the person granting the power) may have since revoked the power. In that event, the principal might disavow any transaction a bank (or other third party) handled in reliance on the power of attorney. For this reason, a revocation of a power is only binding upon a third party once they receive actual notice of the revocation.

Gifting language in the Durable Power of Attorney

Most Powers of Attorney do not contain express gifting language, or have gifting language limited to the annual gifting limit (originally \$10,000, now \$11,000).

A major reason to have a Durable Power of Attorney in place is to provide a way to be able to reach assets should we wish to initiate some transfers to children so as to qualify for medicaid benefits without first exhausting all resources in the payment of a nursing home bill.

Currently, if we make a transfer of assets (usually to preserve assets in the event nursing home care is required), and we tell Medicaid (the DMA) about it, THEY BELIEVE US! We simply calculate how long we wait to qualify for medicaid, and then proceed.

However, someday soon, Medicaid is going to want to see proof of the transfer, and they will examine the Durable Power of Attorney for gifting authority. If the Power does not contain gifting language, the DMA will disallow the transfer on the grounds that the agent had no authority under the Power to make a gift. If no gift occurred, then the asset still belongs to the medicaid applicant, which means he has more than the permitted \$2,000, which means he does NOT qualify for benefits. This is good for the Medicaid and bad for us. It is good for Medicaid because if they can deny benefits their "bottom line" looks better, since they are saving money.

Thus, a properly drawn Durable Power of Attorney should contain explicit gifting authority (NOT tied to any "past gifting practices", or limited to any annual exclusion amount).

HEALTH CARE PROXY

In response to the *Nancy Cruzan* case, decided by the United States Supreme Court, as of January 1, 1991, we now have in Massachusetts a "Health Care Proxy Statute", which gives legal recognition to your designation of some person to act as your health care agent regarding medical treatment. A separate form has been created by the Massachusetts Office of Elder Affairs; completion of this form as part of your overall estate plan is highly recommended.

This is because recent state regulations require hospitals to inform you of your

right to execute a health care proxy, and to supply the form. Unfortunately, the time to think about terminal illness decisions is NOT at the time of admission to the hospital; at that point, you are usually only interested in thinking about a positive outcome to your hospitalization, and you DO NOT want to think about the possibility you might die.

Thus, it is best to consider your terminal illness decisions in the relative calm and stress-free atmosphere of creating your overall estate plan. Then, if a later hospitalization becomes necessary, you can focus all your energies on a successful outcome to the hospitalization, and yet know that you have already made your decisions about terminal illness care.

HIPAA MEDICAL PRIVACY LAW

The Health Insurance Portability and Accountability Act, known as HIPAA, enacted privacy regulations effective as of April, 2003. These regulations are designed to ensure the privacy of all persons' medical information. There are criminal and civil penalties to doctors and hospitals for the unauthorized disclosure of confidential medical information. Because much of the medical community is frozen in fear of violating HIPAA, we are seeing some unintended and absurd results, such as Jane's inability to learn the whereabouts or status of her mother.

As a result of HIPAA, doctors, nurses, hospitals and other health care providers are no longer able to discuss a patient's status or health with spouses or other family members. They may only do so if the patient had previously signed a consent form authorizing such disclosure.

Nowadays, when you go to the doctor's office, you are being asked to sign certain forms relating to HIPAA. Unfortunately, these forms are merely a disclosure of the new requirement to maintain confidentiality about medical information. The forms *do not* authorize any family member to receive medical information about you. Without such authorization, the family will not be able to learn anything about your medical status.

All persons should sign a HIPAA Authorization and Release. This document designates one or more family members to receive medical information on your behalf.

The HIPAA Authorization should not be confused with the Health Care Proxy. The Health Care Proxy designates someone to make medical decisions on your behalf, but *only when* you are no longer able to make your own decisions. The HIPAA Authorization would allow family members to receive information about your medical status, even though you are still making your own decisions.

While the intent of HIPAA is laudable - it guarantees that information about patients cannot be sold to marketers or shared with employers - it has also created stress and anxiety on families, who are finding they are unable to learn the medical status of their relative. In order to make sure that family members are kept in the information loop, all persons should sign the necessary Advance Directives - HIPAA Authorization and Release (so family can learn about a person's medical status) and Health Care Proxy (so a family member can be designated to make medical decisions for you when you

cannot).

LIVING TRUSTS

A trust can save substantial amounts in probate expenses and administrative time. It provides flexibility, security and privacy in administering your assets.

Testamentary vs. living trusts.

A trust is either testamentary or "inter vivos" (that is, made during life; it is also known as a living trust). A testamentary trust is incorporated within your Last Will and Testament. All other trusts (not included in your Will) are living trusts. There are as many different varieties of living trusts as there are reasons to have them. Living trusts are often used in medicaid estate planning as a vehicle to protect assets against possible nursing home costs.

A trust is an arrangement under which the trustee holds assets (the trust corpus) for the benefit of the trust beneficiaries. You, as the person who establishes the trust, are referred to as the Settlor, or Donor, or Grantor. The trustee holds the legal title to the trust corpus, but the assets do not "belong" to the trustee. The real owner of the assets is the beneficiary. The beneficiary is the person designated by the Donor to receive the benefit of the trust. The beneficiary can be the Donor, or anyone else the Donor selects. The goal or objective the trust is intended to accomplish will usually determine who the beneficiary will be.

The trustee's responsibility is to invest and manage the trust assets, to distribute property to the beneficiaries, and to prepare and file the appropriate accounting and income tax returns.

A living trust is entirely private and confidential, and your financial affairs are not subject to public scrutiny, as they would be in a testamentary trust. Additionally, a living trust provides a vehicle for management of your assets should you become disabled in the future.

Funded vs. unfunded living trusts.

In addition to the difference between the "living" and the "testamentary" trust, there is a difference between a "funded" and an "unfunded" trust. An unfunded trust is one where no funds are placed in the trust at the time of its execution, other than, perhaps, a nominal amount. Assets may later be added to the trust during your life, or via a bequest in your Will.

Revocable vs. irrevocable living trusts.

A living trust can also be "revocable" or "irrevocable". With a revocable trust, you, as the Settlor, can change any of the trust terms, or terminate it and require the trustee to return any assets to you. Additionally, you can act as the initial trustee, naming a substitute trustee to take over in the event of future incompetency.

An irrevocable trust is far more restrictive. Because it is irrevocable, the trust, once created, cannot be altered or ended. You may be the beneficiary, but some independent person (often an adult child) would act as the initial trustee. An irrevocable trust is usually a funded trust, and therefore, your trustee would be managing your assets for you now, even though you remain mentally competent to do so yourself. An irrevocable trust is only used in highly selective circumstances such as Medicaid planning.

ESTATE TAXES

Inheriting the assets is only half the story. Regardless of how property is transferred, all property owned by decedent is subjected to a death tax. This is known variously as an estate or inheritance tax. In Massachusetts, we had an estate tax until 1997, when we switched to a "sponge tax". On January 1, 2003, Massachusetts re-enacted its own estate tax, and selected \$700,000 as the tax-free floor. This figure will rise each year until it reaches \$1M in 2006, where it will stay.

Thus, regardless of whether property has passed by virtue of surviving joint ownership, as a named beneficiary, or via probate, it's all subject to estate tax. A very common mistake is for a surviving spouse to inherit all via joint ownership, and assume nothing need be done since no probate proceedings were required. In fact, something may remain to be done, particularly when the decedent owned any interest in Massachusetts real estate.

For federal purposes, the threshold for estate taxes is currently \$1.5M (\$850,000 for Massachusetts). This floor is gradually increasing to 3.5M in 2009. In 2010 the estate tax is repealed. HOWEVER, for deaths occurring in 2011 and beyond, the federal estate tax is reinstated, with a tax-free threshold of only \$1M!

Under current rates, estates which are over the tax-free threshold will pay an estate tax which is computed at rates between 37% and 49%, depending upon the size of the estate. For example, a taxable estate of \$2M produces an estate tax of \$225,000 federal, plus \$103,920 to Massachusetts. (\$328,920 in total). A taxable estate of only \$500,00 more, or \$2.5M, results in a federal estate tax of \$470,000, plus a Massachusetts tax of \$143,600! (\$613,600 in total). That is double the tax for a small increase in the total estate.

MARITAL AND CREDIT SHELTER TRUSTS

Regardless of which spouse dies first, there is no federal or Massachusetts tax to pay, assuming the surviving spouse is a United States citizen. This is because of the *marital deduction*, which provides that 100% of everything passing to the surviving spouse will pass tax-free. All taxes will be due upon death of the second spouse.

The story is very different when the second spouse dies. At that time, the second spouse will die owing everything, and thus an estate tax will be imposed on the total estate.

It is possible to eliminate every penny of tax up to a combined estate of \$3M in 2005 and \$4M in 2006 (However, Massachusetts has its own estate tax, with savings limited to a combined estate of \$2M at the state level). This is done by taking better advantage of the estate tax rules. Under the present scenario, the first spouse to die is leaving everything to the surviving spouse.

Currently, we pay no tax on the death of the first spouse, because of a marital deduction. This means that anything that passes to the surviving spouse passes tax-free BECAUSE the recipient is the surviving spouse. This means the first spouse can leave a “zillion” dollars to the second spouse tax-free.

The problem comes upon the death of the second spouse. When the second spouse dies, we have no surviving spouse (since the first spouse is already dead), so everything above the tax-free amount (\$1.5M in 2005) is taxed. Since our surviving owns everything, which could easily total more than \$1.5M, we will owe considerable estate tax.

The way to avoid the entire estate tax is take advantage of the \$1.5M credit which is available to everyone, including our first spouse to die. Because we left everything to our surviving spouse, we “wasted” the credit available to the first spouse to die, since the second spouse got everything tax-free anyway, by virtue of being the surviving spouse (and NOT because of the \$1.5M rule).

We need to structure our estate plan in such a way that in the estate of the first spouse to die, everything up to \$1.5M is subject to estate tax, with any balance over that amount going to the surviving spouse. The result then would be that the first \$1.5M is subject to tax. However, no tax is actually due because of the estate tax rule that the first \$1.5M is tax-free.

Then, when the second spouse dies, he or she is only taxed on any excess over their own \$1.5M credit. This strategy would allow us to pass up to \$3M tax-free (\$1.5M x 2) to the children, instead of only \$1.5M once.

And, we need to add additional language to reflect the Massachusetts differences so we pay the least amount here, too.

Thus, instead of the children paying significant amounts in taxes, both federal and state, that can inherit the exact same amount of assets, and pay significantly less tax, and maybe even none! The difference is all HOW they inherit it.

WILLS

Standard of competency to execute a will.

In Massachusetts, to execute a will, a person need only have a general idea of what he owns, and who are the persons who are the "natural objects of his bounty." If a person is largely incompetent, and even the subject of a court appointed guardianship, so long as the person is generally aware, he is sufficiently competent to make a will.

If the ward does not meet the standard for competency, his court appointed guardian may plan his estate for him. This can encompass gift giving, drafting a will, drafting new trusts and amending old ones, transferring ownership of assets and for Medicaid planning. The planned disposition by the guardian must be consistent with the intentions of the ward insofar as those intentions can be ascertained. And remember, any proposed change requires Court approval, and any creditors can be given the opportunity to object to any transfers away from the ward.

The drafting of a will is essential if no trusts are in existence, and when combined with trusts, nicely rounds out the entire estate plan, so as to catch all assets.