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Estate Planning Update July 2018 - Planning for Incapacity Using Revocable Trusts

Along with an increased life expectancy due to medical advances comes an increased chance of developing diminished mental capacity. Planning for this possibility should therefore be part of a comprehensive estate plan. While a durable power of attorney is the most familiar estate planning tool in planning for incapacity, and conservatorships are often sought for people who have lost legal capacity, people often overlook perhaps the best alternative—a funded revocable trust (also sometimes called a living trust). A durable power of attorney allows the agent named in the document to manage the financial affairs of the principal, even if the principal is incapacitated. However, relying entirely on a durable power of attorney is not necessarily the best solution. It may be difficult to get financial institutions or other holders of assets to accept a durable power of attorney. In addition, some financial institutions will take the position that the passage of time makes a durable power of attorney "stale," and they may therefore refuse to accept a durable power of attorney that was executed several years ago. A principal could execute a durable power of attorney in one state and find it difficult or impossible to have it accepted by financial institutions in other states or countries. A revocable trust is often introduced as a means of avoiding the delays and loss of privacy that result from probating a will. It is important to understand that a funded revocable trust can also serve a valuable function in the event of incapacity. It can:

- Allow a settlor to continue to manage his or her assets while competent, alone or with the participation of a co-trustee
- Provide for the ongoing management of the settlor's assets in the event of incapacity, with greater convenience and flexibility than a power of attorney
- Provide for accountability of the trustee to the settlor and family members without the public filings required by a conservatorship proceeding

As a result of the extensive use of revocable trusts in recent years for both estate planning and business planning, financial institutions are familiar with them and are accustomed to accepting a trustee's ongoing authority to act on behalf of a trust. The revocable trust can be provided to the financial institution at any time, and any questions or concerns can be addressed up front rather than after incapacity. The benefits of a revocable trust generally include:

- More flexibility in designating who will act on behalf of the settlor. For example, it can provide mechanisms for naming additional and successor trustees beyond those named in the document and for removing trustees who may not be acting in the settlor's best interests. It can also divide responsibilities among different trustees; for example, separating responsibility for making distributions for the support of the settlor, or gifts to his or her family members, from responsibility for investment decisions.
- More transparency, by requiring the trustee to provide periodic accounts to the settlor or to other family members. The accounts typically are provided directly, unlike a conservatorship in which they are provided to a court.
- It can be funded at any time while the settlor is living and competent; it could even be funded after the settlor's incapacity by means of a durable power of attorney, although waiting for the settlor's incapacity to fund the trust is not ideal due to the issues raised above.
- It can be further customized in order to carry out the settlor's intentions in the event of incapacity.

To give an example: Settlor is competent but is concerned that he has been acting in ways that are against his best interests—making impulsive investment decisions or promising to make large gifts to acquaintances, for example. He is

concerned, based on medical diagnoses or his own observations, that these problems may get worse. However, he does not want to give up the management of his investments or his ability to make gifts as long as he remains competent. Working with his Day Pitney estate planning attorney, he could amend his revocable trust to:

- Add one or more co-trustees, who could be a relative, a trusted advisor or both
- Provide that certain actions, such as making new investments, making large gifts to friends or changing the provisions for loved ones upon his death, require the consent of the co-trustees
- Still participate in all these decisions as long as Settlor had capacity and could still act independently to pay his bills and make gifts to his relatives
- Still have full access to all account statements and remain fully aware of all actions taken with respect to the trust assets

All told, when planning for incapacity, a funded revocable trust is likely the best solution. While the settlor is living and competent, the settlor can retain control over the trust property and the trust property continues to be treated as owned by the settlor during the settlor's lifetime for income tax purposes. Upon the settlor's incapacity, one or more successor trustees take over management of the trust property and administrative safeguards apply, all without delay, publicity or court involvement. Please contact your Day Pitney estate planning attorney if you would like to discuss this planning option.