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Estate Planning for Disability

Planning for the possibility of disability is probably the most overlooked part of estate planning. While many people will give serious consideration to estate planning for their death, few will seriously consider planning for their disability. Yet disability planning should be the more important part of estate planning from the client's perspective both because it benefits the client directly, and because, until a person is well past retirement age, the probability of becoming disabled in the next year exceeds the probability of dying in that period.

The best vehicle for disability planning is a fully funded trust - usually a revocable living trust. Estate planning professionals need to know how to assist their clients in designing their living trusts, both to provide for taking care of the client in the event of the client's disability and to provide for anyone who is dependent on the client when the disability event occurs.

In this issue of *The Wealth Counselor*, we will examine what happens when someone becomes disabled and has not planned for it, and how the right planning can prevent a court from having to step in to protect the client and the client's assets. Proper planning can allow the advisory team to continue its role in helping manage the client's assets and provide for the client and the client's dependents.

The Team Approach to Planning for Disability

Clients are best served when all of their wealth planning professionals are working together on their behalf. Certain legal documents are required for proper disability planning, but even the best legal documents are ineffective unless the client, with their financial advisor's help, sets up the client's financial resources to support them. So, too, financial planning for disability is a very good thing, but the best financial planning is ineffective without proper legal planning to empower trustees and agents to act in the place of the client when the client is unable to do so. The advisory team (attorney, CPA, insurance advisors, financial advisors, and sometimes even the client's doctors) must work together to integrate planning that will be effective should the client suffer a disability event.

Disability Planning Defined

Disability planning is planning for when the client is mentally incapacitated to the degree that the client is not competent to make business or personal care decisions or so physically disabled that the client cannot communicate directions for the management of the client's affairs.

A person is considered *incompetent* when a medical determination has been made that the individual does not have the mental ability to make business or personal care decisions.

A person is *incapacitated* when a court has declared the person legally incompetent to make business or personal care decisions. When a person is determined to be incapacitated, the court will take away the person's right to make personal care and business decisions and may empower someone else to do so under the court's supervision.

Planning for disability is vitally important because disability can happen to anyone, at any age, and at any time. Many of our clients tend to think of disability as being something that only happens to old people, like when they develop dementia. However,

as noted earlier, a person's probability of dying in the next year is much lower than his or her probability of becoming disabled in the next year unless the person is well past retirement age. With people living longer due to advances in medicine, their lifetime probability of becoming disabled is increasing. Today, the odds are better than 50:50 that any given person in the U.S. will have some period of incapacity.

But younger, healthy people can suddenly become disabled from accidents or illnesses—or even acts of violence. For example, Terry Schiavo was just 29 years old when she suffered a cardiac arrest that resulted in permanent profound brain injury. The consequences of disability without planning can add another level of disaster. That is why all of our clients, regardless of age and wealth, need disability planning—just in case.

What Happens if We Don't Plan: Life Probate

Most people think of probate as a legal process for changing titles on assets from the name of a deceased person to the name of the deceased person's beneficiaries or heirs. But there is another probate court process, a "living probate."

Living probate is what happens when someone is alleged to be incompetent to manage their own affairs. Someone literally sues them in a probate court, asking the judge to take away their right to make their own care and/or business decisions and give that right to someone else. It is an expensive process in which the alleged incompetent person pays the lawyers on both sides. If the person is found to be incompetent to manage their business affairs and there are business affairs to be managed, the court will appoint a guardian or conservator to do so. The court will require that the guardian or conservator post a bond against theft or mismanagement and provide a detailed accounting to the court on a periodic basis for the court to audit. Sometimes the responsibility for the physical care of a disabled person and the responsibility for the management of assets that are titled in the disabled person's name are given to two different people: a guardian/conservator of the person (for physical care) and a guardian/conservator of the person's assets (for financial care).

If there are no assets titled in the incapacitated person's name, such as when the person's assets have been placed in a trust, the court has no need to appoint a guardian/conservator of the incapacitated person's assets. This is just like there is no need for post-death probate if there are no assets titled in a deceased person's name that are not controlled by beneficiary designation.

Because the courts jealously guard everyone's rights to manage their own personal affairs and property, living probate provides a form of protection that is anything but free. Living probate, especially when there are assets to be managed, is costly, time consuming and cumbersome with annual accountings, bonds, reports, ongoing determinations of incapacity/incompetency, and fees for attorneys, accountants, doctors and guardians. All those costs are paid from the disabled person's assets, and all living probate proceedings are a public record. Once a guardianship/conservatorship is established, it will go on until the incapacitated person dies or the court determines that he or she is no longer incapacitated. That can be many years.

Another possible problem is that a court cannot allow an incapacitated person's resources to be used to provide care for anyone who is not the incapacitated person's legal responsibility. That means that adult children, parents, grandchildren and others for whom the disabled person was providing support will be on their own.

> ***Planning Tip:*** The probate court will usually require that all assets of an incapacitated person, other than a home occupied by the incapacitated person, be liquidated if they are not already in the form of FDIC insured accounts or U.S. government securities. In many cases, that will mean loss of assets under management and the loss of a client relationship for the person's financial advisors.

A Fully Funded Revocable Living Trust Avoids Living Probate
When a living trust is fully funded, all titles of assets are changed from the individual's name to the name of the trustee and new assets acquired are taken in the name of the trust. Then, if the client becomes disabled, there is no reason for a living probate for asset management because the client does not own any assets in his own name that need managing. While a guardian/conservator of the person may still need to be appointed by the court, a fully funded living trust will allow the advisors to continue to be involved with the management of the client's assets under the direction of the client's successor trustee.

Living Trust v. Durable Power of Attorney
A durable power of attorney is not a substitute for a fully funded revocable living trust for several reasons. For example:

* A durable power of attorney will endure the disability, but not the death, of the asset owner (principal). A living trust, on the other hand, is not affected by the trust maker's death.
* A holder of trust assets cannot decline to accept the authority of the trustee (or successor trustee). A durable power of attorney, on the other hand, works only if whoever is holding the assets decides to accept it. That can be a real problem. Perhaps whoever is holding the assets will think the power of attorney is not broad enough to be acceptable. Or perhaps that it is too complex to understand without a legal opinion that the asset holder is unwilling to seek. Powers of attorney also may not be accepted if more than a certain number of days or months have elapsed since they were executed. This is a particular problem when the power is given to a spouse. Many institutions will not accept a power of attorney unless it is on their own form. We could go on. With a living trust, the trustee is the owner of the trust assets; institutions and securities transfer agents must honor the trustee's ownership.
* Durable powers of attorney will not endure the disability or death of the agent to whom the power is given. If the principal is disabled, a living probate will likely be needed if no successor agent is available and willing to serve. By contrast, a trust will not fail for lack of a trustee. A well-drafted living trust will contain trustee succession provisions, and even if all named successors are unavailable to serve, a professional trustee can be appointed.
* A living probate will cause all powers of attorney to terminate; the court will simply take over and put a conservator/guardian in charge. As explained earlier, a fully funded living trust will eliminate the need for a guardian/conservator of the estate because there is no estate.
* If the power of attorney fails to work for any reason at the principal's disability, a living probate may be the only solution for taking care of the principal. The guardian/conservator of the estate will be someone appointed by the court. If the incapacitated person has not made his or her wishes known by a certain kind of formal document, the court may choose someone who is a professional guardian/conservator but a total stranger to the family. With a living trust, the client handpicks the successor trustees for his/her trust.
* Federal agencies, such as the IRS and the Social Security Administration will generally not honor powers of attorney; agents cannot cash Social Security checks or sign tax returns. With a living trust, Social Security checks can be set up ahead of time for direct deposit to a living trust account and a trustee will be empowered to deal with the IRS.
* A power of attorney must contain very specific instructions for running a sole proprietorship or other business entity. If the sole proprietorship or business entity is owned by the living trust, the successor trustee will have no problem stepping in and running the business. The successor trustee can also hire other persons to run the business if the successor trustee does not want to run the business or does not have the proper license to do so. An agent does not have the power to delegate.

Additional Documents for Disability Planning

Durable Power of Attorney

A durable power of attorney can be useful. Often one will be accepted to transfer titled assets to the principal's revocable living trust, and they are effective in managing assets (like IRAs) that cannot be put into the living trust before a disability event.

Durable Power of Attorney for Health Care

Also called a Health Care Proxy or Medical Power of Attorney, this document lets you legally give someone the authority to make health care decisions (including life and death decisions) for you if you can no longer make them for yourself. Without a designated health care agent, your client could be kept alive by artificial means for an indefinite period of time. (Most clients will remember this happening to Terri Schiavo. Terri's tragic incapacity saga and information about the Terri Schiavo Foundation can be found at http://www.terrisfight.org).

Living Wills or Directives to Physicians

A living will is different from a living trust. A living trust is a document used in estate planning for control and management of a person's assets during lifetime and after death, and as explained above, can prevent a living probate at disability because of the way the assets are titled. A living will or directive to physicians is a document that lets a physician know the kind of life support treatment someone would want provided or withheld in case of terminal illness or permanent condition when the affected person cannot make his or her desires known.

> ***Planning Tip:*** A living will or directive to physician is limited, because it addresses the use of life support only in very specific situations when the person's condition makes communication about care decisions impossible. (As a practical matter, if a close family member objects, the physician and hospital will not want to be liable for going against their wishes and may disregard the living will.) By contrast, a durable power of attorney for health care is legally binding and enforceable.

HIPPA Authorizations

HIPPA authorizations give written consent for doctors to discuss a client's medical situation with others the client has designated and to disclose a client's medical information to them. These documents are vitally important for disability planning because they can allow not only family members to discuss a disabled client's situation and prognosis with the doctors, but they can also allow the trustee and members of the advisory team to be kept fully informed.

Defining and Providing for Disability in the Revocable Living Trust

A revocable living trust provides the client the opportunity to define disability in a way that will provide for the continuity of trustee services, to make sure the trust maker and loved ones will be taken care of during a disability, and to ensure that debts, liabilities and obligations will continue to be paid. Options to define disability can include:

* A determination by two physicians that certify that the trust maker is disabled. (HIPPA authority will be necessary to allow the doctors to discuss the client's condition with the trustee and other advisors.)
* A determination of incapacity by a living probate court. (The court does not have to appoint a guardian of the estate if all titles are in the name of the trustee.)
* A determination of disability by a disability panel named in the trust. This option allows the client to pre-select a group of people to determine his/her disability. (An odd number is recommended to prevent deadlocks.)

> ***Planning Tip:*** If the trust maker should disappear or is being detained against his/her will (kidnapped, held hostage, in jail or prison), he/she can be declared disabled so the trustee can take care of the obligations and people who need to be cared for. (In contrast, years must pass before a missing person can legally be declared dead by a court.)

Designing “Take Care of” Instructions in the Revocable Living Trust

The revocable living trust should include instructions regarding the persons who are to be taken care of in the event of the trust maker’s disability. For example, it could be the trust maker only; or the trust maker and spouse; or trust maker, spouse and legal dependents. The trust maker may also want to include others who are not legal dependents, like parents and adult children who are actually receiving support at the time of the trust maker’s disability. Also, priority must be established for those the trust maker would like to care for, in case there are not enough funds to provide for everyone.

> ***Planning Tip:*** It’s also important to find out how the trust maker wants to be taken care of and what things are important to him/her. Are there social, recreation and entertainment needs? Are there religious needs? These instructions can be as detailed as they need to be.

Financial Planning Recommendations for Disability Planning

Proper financial planning requires counseling and is not a one-size-fits-all solution. During the discovery process, determine the client’s desires and insurance needs. Pre-planning for healthy individuals can include:

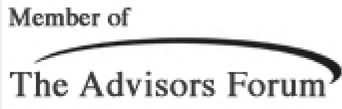
* Disability income insurance to help replace lost income.
* Long-term care insurance to help cover the costs of care that are not covered by medical insurance, including Medicare.
* Life insurance. Waiver of premium provisions have a real cost but, in the event of disability may convert the policy into a paid-up policy. With term policies, check for guaranteed purchase options and conversion of term to permanent life upon disability, but without them, once the term insurance expires, a disabled client would be uninsurable.
* Business or professional overhead expense insurance. This insurance will provide cash to pay monthly business operating expenses (rent, payroll, etc.) so that personal assets will not have to be used to keep a business going. A typical benefit period would be 18 months, enough time to see if the disabled owner will recover or to make arrangements for the sale or transfer of the business.
* Buy out insurance for buy-sell agreements upon disability. The benefit options include a lump sum payment or a stream of income payments over a period of, say, five years.

> ***Planning Tip:*** The healthy spouse usually is the primary caregiver of the disabled spouse. When the disability occurs, it can be wise to secure additional life and disability insurance on the healthy spouse. If the healthy spouse dies or also becomes disabled, additional funds will be needed to take care of the surviving disabled spouse or both disabled spouses.

> ***Planning Tip:*** It is not unusual for one spouse to be more engaged in the planning process than the other. Because a disability affects the entire family, the advisory team should work together to bring the disinterested spouse into the process. Eighty-five percent of women in the U.S. die single, so wives are typically particularly interested in this planning.

> ***Planning Tip:*** Life insurance, long-term care insurance and disability insurance all have special disability provisions, as do retirement plans and IRAs. If the client’s living trust is the owner and beneficiary of the policies, the trustee will have full control and will have access to cash values, waiver of premium riders and term insurance conversion riders.

> ***Planning Tip:*** Unmarried couples (opposite or same sex) need to have a co-habitation agreement that spells out property rights and occupancy rights in the event of death or disability. Each party needs to have a living trust with instructions that take care of each other, and each one needs to have their own health care documents.



Conclusion
Disability before death is usually not expected, but it should be properly planned for. Advisors should put disability planning on the same level as estate planning and impress upon their clients that this planning for life is at least as important as after-death planning. Coordination among all wealth planning professionals remains the best way to plan for clients. Having a good understanding of each other's roles and a close relationship with the client is important in the planning stages, at the client's (potential) disability and after the client's death.

To comply with the U.S. Treasury regulations, we must inform you that (i) any U.S. federal tax advice contained in this newsletter was not intended or written to be used, and cannot be used, by any person for the purpose of avoiding U.S. federal tax penalties that may be imposed on such person and (ii) each taxpayer should seek advice from their tax advisor based on the taxpayer's particular circumstances.

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