***PLANNING FOR ELDERS APPROACHING INCAPACITY AND PEOPLE WITH DISABILITIES*, Financial Planning Association, September, 2002**

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PLANNING FOR ELDERS APPROACHING INCAPACITY

I. PLANNING FOR INCAPACITY–FINANCIAL ISSUES

The goal of estate planning is to help design and determine the future. Fewer people can now rely upon a close and supportive family to be there in times of need. People must therefore rely upon advance planning, which includes the implementation of estate and incapacity planning tools. The following is a summary of the areas that should be planned for and some of the tools available to facilitate an effective, advance financial plan for elders approaching incapacity.

Planning for incapacity is often overlooked, and yet there is a 65% chance that each of us will experience some period of incapacity and a 25% chance we will suffer a long period of incapacity. The best method of planning is to use the following legal tools to appoint a surrogate or substitute decision-maker to assist people when, and if, the time comes.

A. Conservatorship

If a person does not do other planning, as appropriate, a conservator may be appointed by the court. This can occur if, based upon medical testimony, it is determined that the individual lacks the capacity to manage financial resources. The conservator can be an individual, a bank, or other professional fiduciary. The conservator is empowered to take possession of the individual's assets and income, and provide for payment of expenses. The conservator has all the powers that the person would individually possess to manage financial affairs. If a person is incapacitated, he or she no longer has the ability to utilize the planning tools discussed below. The procedures for the establishment of a conservatorship are similar to that of guardianship; in fact, the two powers are often requested at the same time. Also, a conservator is required to be bonded. Annual accountings to the court are also required.

B. Bank – Joint Accounts

A bank officer may recommend that an individual put an account in joint names with a family member or friend. This will allow the joint owner to have access to the account should he or she become incapacitated.

There are potential disadvantages to joint ownership. One joint owner's liability can expose the entire assets to creditor claims. Also, the joint owner can take the entire amount out without the consent of the other. Last, upon death, the account becomes the sole property of the surviving joint owner (despite the terms of a Will or Trust), even if the intention was that the account be joint only for convenience.

C. General Power of Attorney

To minimize the need for a conservatorship or the problems associated with joint ownership, individuals can designate another person, a family member, or friend (called "attorney-in-fact" or "agent") to act legally on their behalf in a durable power of attorney. Simply put, the attorney-in-fact has the power to sign the other person's name to any legal document. Oregon law provides that a power of attorney will continue beyond disability or incapacity. All powers of attorney are not the same. Often people use a form power of attorney that does not include important provisions. Examples of important provisions the client will want to consider are the following:

1. Support of Spouse/Partner. If the person making the power of attorney wishes to allow the spouse or partner to have the funds available for his or her own needs, then this should be specified.

2. Gifting. If gifting provisions are not included, any gifts made by the agent may be treated as a breach of fiduciary duty. Therefore, the client should consider including gifting provisions, either for tax planning, long-term care planning, or to continue financial assistance to a child or grandchild.

3. Authority to Change Estate Planning Provisions. The client should consider provisions to change beneficiary designations, create or modify trusts, and disclaim assets. An agent named in a power of attorney cannot modify a Will.

4. Nomination of Fiduciaries. Despite good planning, a client sometimes becomes involved in a court proceeding such as a conservatorship, guardianship, family law proceeding or other litigation. The client can name who he or she would like to serve if a conservator, guardian or guardian-ad-litem is appointed by the court.

5. Authority to Self-Deal. It can be troublesome if the agent takes action to benefit him or herself. If such activity is allowed, then a provision should be included to authorize self-dealing. It such a provisions is not included, the agent could be accused of breach of fiduciary duty.

6. Special Agent. If it is possible that the agent may benefit from gifting, disclaimer or a change of beneficiary designation, then it is preferable to name a “special agent” with the authority to take such actions.

Clearly some of these provisions give broad authority to the agent, and the client will want to give such broad powers only to someone he or she absolutely trusts.

A financial institution sometimes will not honor a general power of attorney for finances because it does follow that particular institution’s prescribed format or because of the lapse of time. This is a source of great frustration to estate planners who endeavor to provide the tools to clients to plan for incapacity. A bill was passed in the most recent regular session of the legislature prohibiting financial institutions from refusing to recognize a power of attorney solely for the lapse of time. While this is helpful, it remains to be seen how effective this new law will be.

To minimize problems, it can be helpful for the client to appoint an attorney-in-fact for a bank account or group of accounts at that bank or branch. Contact the bank to obtain its form for this purpose.

An example of a general durable power of attorney for finances with optional provisions is attached as Appendix A. An example of a general durable power of attorney for finances that includes disability planning provisions is attachd as Appendix B.

D. Representative Payee

When a person becomes unable to manage his or her resources, several public programs (such as Social Security) provide for a representative payee or fiduciary to receive benefits on behalf of the beneficiary.

E. Revocable Living Trust

A Revocable Living Trust provides an excellent method for managing the financial affairs of an incapacitated person. The trust document can incorporate specific instructions about how funds will be used if the trustor becomes incapacitated. Usually, the trustor, while competent, will appoint a successor trustee to take control of the person's financial affairs when he or she becomes incapacitated. The trustor can customize the provisions of the trust to suit his or her particular needs and wants. Often the need for conservatorship is avoided by a well established and properly funded trust.

1. What is a Revocable Living Trust? A Revocable Living Trust is an agreement that an individual's property and assets will be managed and distributed in the manner he or she desires, both during lifetime and upon death. Its primary benefit is to allow people to manage and control the trust as long as they are able. It is referred to as a "living" trust because it is established during lifetime and, in most cases, goes into effect immediately. It is a "revocable" trust because trustors are free to revoke or amend the trust at any time

as circumstances change. If, due to an accident or illness, a trustor becomes incapable of managing his or her own financial affairs, they may appoint the person(s), often a spouse or other relative, to step in and take over the management of the trust without court approval or supervision. Not only does the trustor decide who the "successor trustee" is, but also instructs the successor trustee how to use funds for their benefit. Trustors also define the term "incapacity" and select the person or doctor who will make that decision.

2. Probate Avoidance. Probate is a court-supervised process providing for the payment of debts and taxes, and the transfer of probate property upon death. Probate property is what a person owns in their own name without survivorship rights. Many people mistakenly believe that having a Will avoids probate. A Will simply directs the probate process - it does nothing to avoid it. People want to avoid probate because they are concerned about the cost ($2,000 to $5,000) and the time delay in obtaining distribution of assets to the heirs (6 to 12 months). A living trust prevents the need for probate because trustors have directed the distribution of assets in the trust document. Trustors may have also appointed a successor trustee to pay debts and taxes, and to distribute the estate.

3. Personal Needs and Quality of Life Planning. The Revocable Living Trust is flexible and can be tailored to an individual's specific needs, desires, and financial resources. Recently, we are seeing an evolution in the drafting of Revocable Living Trusts. The primary purpose of the trust is no longer simply probate avoidance. Now, more focus is being placed upon the beneficiary's "quality of life." One alternative is to draft, as part of a good living trust, language that provides direction and assurance that the trustee will use trust funds to promote the highest quality of life.

Specific instructions about care and comfort are particularly important when the successor trustee is an institution (bank or trust company), or when a family member is very busy or geographically remote. It is important that the trust is clear that the needs of the lifetime beneficiary take precedence over any remainder beneficiaries.

An example of trust provisions that can be included in a Revocable Living Trust is attached as Appendix C.

4. Exercise Reserved Powers. Often the terms of a joint trust will allow the trust to be amended only by both trustors. The option of allowing one trustor to exercise reserved powers should be discussed. Further, the client should consider whether an agent in a power of attorney for finances should be given the authority to exercise certain reserved powers for an incapacitated person.

5. Flexibility for Purposes of Medicaid Planning. The standard Revocable Living Trust specifies that if a trustor becomes incapacitated, that the trustee will provide for the trustor's needs. However, in some instances this traps the trustor into a situation in which Medicaid planning is not allowed. For example, if one spouse is incapacitated, then a Medicaid plan might involve transfer of the couple's assets to the name of one spouse. A client who anticipates a possible future need for Medicaid should consider not doing a

Revocable Living Trust, or, if a trust is created, to incorporate flexible provisions allowing withdrawal in the event of planning. The power of attorney should also be carefully crafted in this situation. An example of language to be incorporated into a Revocable Living Trust in these situations is attached as Appendix D.

6. Successor Trustee Provisions. The trusteeship is a critical role, but the successor trustee provisions are often not given much thought. The client may want to consider giving authority to one trustor to change the successor trustees, or to give successor trustees the ability to name a new trustee or successor trustee. In some cases it is appropriate to give the beneficiaries the ability to name a new trustee, but the trustee should be cautious about giving unfettered authority.

F. Provisions for Pets

Clients often have very important relationships with their pets, and caring for their pets during their incapacity or at death must be considered. Attached as Appendix E is language clients can incorporate into their documents, where appropriate, to assure care for their pets.

II. PLANNING FOR A DISABLED OR INCAPACITATED FAMILY MEMBER

Estate planning most often involves establishing a testamentary distribution of property to heirs and devisees. This process assumes that the heirs are competent to manage the inheritance, make sound financial decisions, and care for themselves independently. These assumptions cannot be made if an heir is also a severely disabled or incapacitated person. In addition, as discussed above, many disabled heirs receive public assistance benefits. Some of these programs, such as Supplemental Security Income (SSI), Medicaid, subsidized public housing, and Food Stamps are "need-based" programs. In other words, eligibility is based upon financial need. A testamentary bequest or distribution to such a person will likely make them ineligible for the public benefit until the funds are liquidated. If a client has a disabled child or other person he or she would like to include in their planning, they have the following options:

A. Outright Bequest to the Adult Disabled Child

This is the simplest option, but seldom the best. The beneficiary will receive the funds with no limitation and with no supervision. Also, if the beneficiary is receiving need-based assistance, the beneficiary will be ineligible for the assistance until the funds are spent down.

B. Transfer to a Third Party

A common method of planning is outright transfer to a third party. The third party is usually a family member or friend who is committed to the disabled person and is trustworthy. In essence, the parent is funding a person who will step into the same role as the parent had providing for the disabled person as needed. The problem with this option is obvious. There is no legal method of requiring the third party to assist the disabled child. The bequest is the sole and unrestricted property of the third party. Also, the funds will be exposed to the third party's own problems, such as creditor problems, divorce, or the third party's own death.

C. Transfer to a Trust

The parent could transfer to a trust established for the benefit of the disabled child. The trust could require the trustee to make distributions of income and principal as the trustee determined necessary for the disabled person. The trust would be structured very similarly to a testamentary trust established for minor children. This arrangement will adequately provide for an incapacitated person who cannot manage their own financial affairs. It may not work for an incapacitated or disabled person receiving public assistance benefits. As discussed below, if the trust assets can be paid or applied for food, clothing, and shelter, the assets may be considered available to the disabled person and could disqualify the person for certain public benefits, such as Medicaid. However, if public assistance eligibility is not important nor likely to be needed in the future, this option is sufficient.

D. Special or Supplemental Needs Trust

Most parents prefer to supplement, rather than to replace, the public assistance benefits their disabled child is receiving. One method of accomplishing this goal is transfer to a special needs or supplemental needs trust. Special needs include education, the telephone bill, internet service, cable television, transportation expenses, and health care needs not otherwise covered. This type of trust provides for management of funds and preservation of public benefits. See Part II for an extensive discussion of special needs trusts.

III. LONG-TERM CARE PLANNING

Few individuals or couples have enough income to pay for the high monthly cost of nursing home care ($2,000-$5,000). If no planning is done, the couple will often exhaust their savings (resources) before applying for Medicaid. By utilizing the state and federal laws governing eligibility for Medicaid, much can be done toward preserving the estate and/or preventing impoverishment of the spouse remaining in the community.

A. Medicaid Eligibility and Benefits

1. Income.

a. Eligibility Level. The rules technically require that an applicant's income be less than $1,635 (2002). Income consists of such fixed items as Social Security, pensions, certain Veterans Administration benefits, workers compensation, fixed annuities, and real property contracts. Only the income of the ill spouse is considered. The community spouse's income will not be counted when determining income eligibility.

b. Income Cap Trust. A special trust is available to assist those individuals over the Medicaid Income Level to obtain Medicaid eligibility. The trust was created through a joint effort between elder law attorneys and the State. You should consult an experienced elder law attorney if an income cap trust is needed.

2. Resources. An individual can have up to $2,000 in cash or other non-exempt resources. An additional $1,500 can be set aside in an interest-accumulating savings account dedicated as a "burial fund."

Jointly held liquid assets, such as joint bank accounts, are considered available to the Medicaid applicant. However, the state cannot force a co-owner to sell a jointly held parcel of real property. A life estate interest in real property is an available asset. Value will be established by considering the fair market value for the property and life expectancy of the Medicaid applicant.

The value of a resource is determined by its "equity value." Equity value is the fair market value of the resource minus encumbrances. "Fair market value" is defined as "the amount a resource can be expected to sell for on the open market." The State uses the county tax appraised value for real property and the blue book for automobiles. These values can be successfully disputed by presenting evidence of actual fair market value (i.e., real estate appraisal).

3. Exempt Resources. Certain resources are exempt and not counted in determining eligibility for Medicaid benefits. These include the person's home, one motor vehicle, household items, personal effects, medical equipment, "hard goods" for burial (including burial space, casket, liner, headstone), and a funeral or burial fund up to $1,500.

4. Penalty for Transfer of Resources. Individuals may desire to give away or transfer property or other assets to a family member, friend, or charity as part of their estate planning goals. Unfortunately, a very complex set of rules govern a future Medicaid applicant's ability to transfer property. Simply put, a transfer of resources may make an person or their spouse ineligible for Medicaid benefits for a period of time.

a. Period of Ineligibility. The disposal of a resource for less than fair market value, by an individual or their spouse, will result in a period of time in which both are ineligible for Medicaid benefits. This period equals the time during which the uncompensated value of the transferred asset could have been used to pay for care at the average private pay rate in the State of Oregon, currently $4,300 per month (10/02). Clients should not make gifts for Medicaid planning purposes without first obtaining the

advice of an elder law attorney. The state is allowed to ask a Medicaid applicant about any transfer of assets made during the 36-month period before applying for Medicaid (called the "look back period"). Any transfer made before that time does not effect Medicaid eligibility. However, transfers made during the 36-month period will be subject to the period of ineligibility. The period for transfers to or from irrevocable trusts is 60 months.

b. Exempt Transfers. There are transfers that are exempt from the above rules and will not result in a period of Medicaid ineligibility. These include transfers to a spouse, transfers to a blind or disabled child, and transfer of the primary residence to a caregiving son or daughter, or a sibling with an equity interest (certain conditions must exist).

5. Protecting the Spouse Who Remains at Home.

a. Spousal Impoverishment Rules. The Medicare Catastrophic Coverage Act of 1988 ("MCCA"), significantly changed previous Medicaid laws, providing greater protection to the income and resources available for the maintenance of the spouse who remains at home (the "community spouse"). Prior to MCCA, a spouse's eligibility for Medicaid often resulted in the impoverishment of the community spouse.

b. Treatment of Resources. The non-exempt assets ("available resources") of both spouses are pooled together, regardless of how title is held. The equity value of pooled resources are "deemed" available to the ill spouse subject to the spousal impoverishment rules discussed below. The community spouse is allowed to keep the exempt assets and some of the non-exempt assets. The amount of non-exempt assets which the community spouse is permitted to keep is subject to a limit referred to as the "community spouse resource allowance" or "CSRA." The community spouse may retain one-half of the couple's combined assets. The value of the assets is determined at the beginning of the continuous period of care. The amount allowed the community spouse is subject to a minimum ($17,856.00 in 2002) and maximum ($89,280.00 in 2002). Once the community spouse's resource allowance has been calculated, the excess resources must be spent down before the institutionalized spouse can be eligible for Medicaid benefits.

> **IMPORTANT NOTE:** Much is currently being done by elder law attorneys to allow the community spouse to keep more than one-half of the couple's assets. Revision of the Community Spouse Resource Allowance should be evaluated in every case, before the spouse begins spending down the assets.

Once the spouse needing care has been determined eligible for Medicaid benefits, there is no need for future assessment of the community spouse's resources. The community spouse may accumulate additional resources without affecting eligibility.

The community spouse is entitled to an amount sufficient to raise his or her monthly income to $1,493.00 (effective April 2002). In determining the allowance, all of the community spouse's monthly income, for all sources, will be considered. If all available

income is less than the allowance, the ill spouse's income will be used to make up the difference. (In addition, the community spouse is entitled to an additional allowance for his or her shelter expenses.)

> **IMPORTANT NOTE:** Elder law attorneys are currently using court orders to increase the income allowance of the community spouse, above Medicaid levels. Again, any spouse in this situation should have an elder law attorney review his or her income and assets.

6. Planning Strategies. Careful planning can go a long way toward preserving the couple's resources and preventing the impoverishment of the community spouse.

a. Spend Down. Often referred to as "split and spend down," this planning approach combines the Community Spouse Resource Allowance (discussed above) with spend down strategies to both prevent the impoverishment of the community spouse and expedite Medicaid eligibility for the ill spouse.

The Resource Assessment is the beginning of the planning process. This "snapshot" of the couple's combined resources determines the amount the community spouse may have while the ill spouse qualifies for benefits. Generally, the community spouse is best off with the highest possible allowance.

The Resource Assessment "freezes" the couples' available assets at the time the continuous period of care begins. Spend down or transfers made subsequent will not change the figures produced by the Assessment.

Once the Resource Assessment is complete, the community spouse may transfer his or her share (the community spouse's resource allowance) into the community spouse's own name. The remaining amount may be left in the name of the ill spouse, or preferably, their joint names. This amount must then be spent down before the institutionalized spouse will be eligible for Medicaid benefits.

b. Exempt Resources. Spend down often begins by purchasing or maximizing exempt resources. Some examples are:

(i) Purchase a residence;

(ii) Repair the existing residence;

(iii) Purchase car (with long-term warranty);

(iv) Personal property (appliances, clothing, home entertainment);

(v) Medical equipment;

(vi) Burial goods and merchandise;

(vii) Travel

c. Converting Resources Into Income. Monthly income in the sole name of the community spouse is not considered available to the ill spouse. Therefore, the community spouse may convert a non-exempt resource into an income source (i.e., real estate contract) or he or she may use non-exempt assets to purchase an irrevocable income source (i.e., single premium, immediate annuity).

IMPORTANT NOTE: While an annuity can be a very attractive planning tool, see an elder law attorney to be sure it fits the client's particular circumstances. The extra income provided by the annuity may reduce the amount of the community spouse income allowance or bring the monthly income over the income cap. Also, the timing must be right, or the annuity purchase will not have maximum effectiveness.

d. Court Order. The community spouse can go to court and ask the court to allow him or her to keep more of the assets or more of the income. This should be considered for couples with countable assets under $200,000. The house and one vehicle, as well as other exempt resources described above, do not count.

e. Transfers by Gift. The gifting of assets should be considered a dramatic form of planning. While it may preserve assets, it also can be a significant risk. Gifts can be made to a community spouse with no period of ineligibility for Medicaid. Gifts to individuals other than a spouse will trigger the period of ineligibility discussed above. Again, there is a minimum 36-month look back period.

Either spouse may therefore give away (or sell for less than fair market value) an asset as long as both are prepared to wait out the ineligibility period. This has been referred to as the transfer and wait strategy.

IMPORTANT NOTE: Remember, gifts are irrevocable. If a person is relying upon the recipient to return the funds (or portion thereof) if needed, consider what would happen if the recipient were to die, divorce, or become indebted. Do not make gifts without prior legal advice.

f. Transfers to Trust. In the past, transferring assets to a specialized form of trust could protect some of the assets. Congress changed the rules governing trusts when it passed OBRA 1993, effective August 1993. These new rules substantially restrict the use of trusts for long-term care planning purposes. A few types of trusts are still effective. One type of trust that is specifically allowed by federal law is a special needs trust created in the Will of one spouse for the benefit of a surviving disabled spouse.

g. Staying Off Medicaid. Finally, the best plan may be not to apply for Medicaid benefits. Some disadvantages of Medicaid include discrimination against Medicaid patients, not all facilities accept Medicaid, and impact of estate recovery upon the death of the surviving spouse.

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