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Memorandum

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Subject: Planning for Possible Disability; Advantages of a Standby Trust

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Anyone of any age may unexpectedly become ill or disabled in some way, and unable to manage his or her affairs. This could be a temporary situation or, in some cases, more permanent in nature. It is possible that the affected person could lose access to funds or other assets because he or she may be unable to sign his or her name, or he or she may even be unable to communicate at all. It might literally become impossible, without legal intervention at the time of the illness or disability,[1] to provide, financially, for the affected person's care and for the support of his or her family.

With some forethought, however, and with advance planning, these difficulties can be ameliorated and the distress (not to mention the cost and delay) of the appointment of a guardian can be avoided.

Depending upon individual circumstances, a relatively simple arrangement, such as a "durable" power of attorney or a joint checking

[1] Court proceedings for the appointment of a guardian would be required.

account, may be all that is needed.[2] Sometimes, a more complex arrangement may be appropriate, including a "standby trust." What are these devices and how do they work?

DURABLE POWER OF ATTORNEY

Almost everyone knows, at least in a general way, what a power of attorney is: The signer (called the "Principal") grants to a trusted person (the "Attorney-in-Fact" or "Agent")[3] the authority to sign the Principal's name. The Agent can draw checks on the Principal's account, sell the Principal's stocks, bonds or other assets to raise cash that may be needed, and take other legal steps on behalf of the Principal.

The power of attorney takes effect as soon as it is signed. This may be unsatisfactory to someone who is signing only as a precaution against future disability. One method of dealing with that problem is to have the power of attorney document held by a trusted third party who is not the Agent. The third party agrees to deliver the power of attorney to the Agent only if the third party believes that the Principal has become unable to manage his or her financial affairs.

A power of attorney can be limited to a particular account or transaction, or it can be "general." A general power of attorney grants authority to the Agent over all the financial affairs of the Principal, and, if desired, over other aspects of the Principal's personal and business matters. It is critical that the Agent be someone in whom the Principal has complete

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[2] The simplicity of the New York durable general power of attorney has been diminished by recent legislation, which mandates the use of a new, somewhat complicated, and flawed standard form.

[3] The Attorney-in-Fact or Agent can be any trusted person; despite the use of the word "attorney" in the title, he or she need not be a lawyer.

trust. Similarly, if a person is to be given the responsibility of holding the document and deciding when it is to be delivered to the Agent, that person must be chosen with care.

A power of attorney can be cancelled by the Principal at any time, and it automatically expires at the death of the Principal. At one time, the law decreed that a power of attorney also expired when the Principal became legally incompetent (just when it was most needed). In recent years, New York, New Jersey, and many other states have changed their laws to permit a Principal to sign a power of attorney that remains in effect even if the Principal later becomes incompetent. This is known as a "durable" power of attorney. A durable power of attorney can be a useful safeguard for someone who wishes to assure that his or her bank accounts and other assets will be accessible should he or she become disabled and unable to manage his or her affairs.

JOINT ACCOUNT

A joint account is no doubt the simplest way to make sure that funds will be accessible. A married or domestic partner couple generally should have at least one joint checking account or other joint bank account. Checks that are payable to either of the joint owners of a joint account can be deposited into the account, even if the payee is unable to endorse the checks. And either joint owner can write checks or make withdrawals from the account. Thus, even if one of the joint owners is disabled or unable to sign his or her name, his or her income can be deposited and his or her bills can be paid.

The joint owners need not be husband and wife or domestic partners. It is not unusual for an elderly parent to set up a joint account with a child for convenience, with the intention that the funds in the account are to be used by the child for the benefit of the parent, as needed.

PROBLEMS WITH THE POWER OF ATTORNEY AND THE JOINT ACCOUNT

The power of attorney and the joint account are useful tools. Every well thought-out plan to protect against the legal problems that may be caused by disability will probably include one or both of these devices. They may not, however, be the full answer.

A general power of attorney gives the Agent sweeping authority over the collection and expenditure of the Principal's assets, but it provides only limited guidance as to how that authority is to be exercised. In many circumstances the Agent will want to feel comfortable that he or she is not going to be criticized and possibly sued later on by family members or others concerning his or her decisions on how to spend the Principal's money for the Principal's support and well being.

A similar problem exists with the joint account. The joint owner has access to the money but has no ground rules as to how and when the money is to be spent. Furthermore, particularly where an elderly parent has several children and sets up a joint account with one of them, this arrangement must be employed with care, because, if the parent dies, the money in the joint account automatically becomes the property of the child whose name is on the account (unless it can be shown that the account was established for convenience). This may cause unintended unfairness in the distribution of the parent's estate.

THE STANDBY TRUST

The shortcomings of the power of attorney and the joint account as exclusive arrangements for the management of assets in the event of disability can be overcome by the use of a standby trust. First of all, we will explain what a trust is, and then we will describe the variation that makes a trust a "standby" trust.

A trust is a written agreement under which one person (the "grantor") transfers assets to another person (the "trustee"). The trustee is required to hold, invest, and disburse those assets in strict conformity with the grantor's directions as spelled out in the trust agreement. In the kind of situation we are discussing, the trust agreement would contain directions requiring the trustee to use the income (and principal if necessary) for the support, maintenance, and comfort of the grantor. The trust agreement should also state that the well-being of the grantor is the primary purpose of the trust, and should prohibit anyone from asserting later on that an expenditure for the benefit of the grantor by the trustee was excessive or unauthorized.

Normally a trust agreement is "funded"; that is, money or other assets are transferred by the grantor to the trust at the time the trust agreement is signed. But, when a trust is being set up only as a precaution against future disability, it's not necessary to fund the trust at that time. The trust can be an empty vessel to be filled only if and when the grantor becomes unable to manage his or her own affairs. That is what is meant by a "standby" trust; the trust is signed, but remains unused and on standby until it is needed. How, though, is it activated? Since, by definition, it is not to be funded unless the grantor becomes disabled, if he or she does become disabled, will he or she be able, mentally and physically, to take the necessary steps to fund (transfer assets to) the trust at that time? Here is where the durable power of attorney comes in again.

When the grantor signs the trust agreement, he or she con-currently signs a durable power of attorney. The power of attorney can be a general power, or it can be limited so that the Agent's only authority is to transfer the grantor's assets to the standby trust. This combination of a durable power of attorney and a standby trust provides, in our judgment, a suitable arrangement for the collection and management of the grantor's assets in the event of his or her disability, while providing the grantor with

retained control over the assets so long as he or she is not disabled.[4]

The standby trust, being a species of revocable trust, can be cancelled by the grantor at any time as long as the grantor is legally competent. If assets have been transferred to the trust by the grantor (or by the Agent under the power of attorney), then if and when the trust is revoked, the assets will be returned to the grantor.

The standby trust can also serve as a means of disposition of the grantor's estate upon his or her death. If the standby trust is funded before the grantor's death, the assets remaining in the trust at his or her death are not part of his or her estate for probate purposes; that is, they do not pass under his or her Will and are not subject to the control (or costs) of the probate court.[5]

The standby trust may also be used as a "pour-over" vehicle. This means that the grantor's Will would provide that any assets remaining in the grantor's name at his or her death are to be transferred to the standby trust. The standby trust should contain clauses covering the distribution of the trust's assets upon the grantor's death. In effect, the standby trust serves as the grantor's Will for part or all of his or her estate.

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[4] It should be noted that there are no tax advantages or disadvantages in this arrangement. The grantor's assets are treated, for tax purposes, as his or hers, both before and after the funding of the standby trust.

[5] They are, however, part of his or her estate for estate tax purposes.

ADVANCE DIRECTIVE CONCERNING MEDICAL CARE

Sometimes, when these matters are being discussed, clients also wish to talk about the possibility that they may become terminally ill with no realistic hope of recovery. We have all heard of cases in which persons with no discernable cognitive functions and no hope of regaining such functions are kept alive by artificial means only because medical science knows how to keep them alive. It is possible to provide some guidance to one's family and physicians in this regard by an advance directive, sometimes called a "Living Will."

In addition, New York law provides for Health Care Proxies.[6] A Health Care Proxy is a document under which a person names someone to make medical decisions for him or her should he or she become incapable of making such decisions. This is not limited to situations of terminal illness or hopelessness. Anyone of any age could have an accident of suffer an illness which leaves him or her unconscious or otherwise incapable of communicating medical decisions. If there is a trusted relative or friend who would be willing and able to assume the responsibility of making medical decisions under those circumstances, then a Health Care Proxy naming that person as Health Care Agent should be signed.

We can advise on all the matters discussed above and prepare the necessary documents in accordance with the client's wishes.

[6] In New Jersey, they are called "Proxy Directives."