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Summer 2012

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Recommended Citation

David M. English, Financial Decision-Making for Adults Lacking the Capacity to Make Their Own Decisions, 36 *Generations* 66 (2012).

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Financial Decision-Making for Adults Lacking the Capacity to Make Their Own

Powers of attorney, living trusts, and the ins and outs of naming surrogates.

A significant percentage of individuals lack sufficient mental capacity to make financial, health, and personal-care decisions for at least some period during their lifetimes. For those who die suddenly, that period may be brief. For those with Alzheimer's Disease or other forms of dementia, the period of incapacity may last many years.

Several techniques exist for those wishing to plan in anticipation of future incapacity; most involve designating a substitute (called a surrogate) to make decisions on the incapacitated person's behalf. The most significant of these techniques is the signing of a power of attorney. In addition, the individual might sign a revocable living trust; when properly funded, revocable living trusts can be effective, not only for managing assets in the event of incapacity, but also for avoiding the probate process at death.

In most states, finances and healthcare are addressed separately—but powers of attorney may relate to either.

For individuals who fail to plan before losing capacity, the court will often appoint a guardian of the person or conservator of the person's property. While there are legitimate and appro-

appropriate reasons for appointing a guardian or conservator, most people should plan in advance, creating a power of attorney in order to avoid guardianship and conservatorship. A lesser but still significant number of individuals should consider creating a revocable living trust.

Federal benefit programs are subject to different rules: For a benefits recipient it has deemed incapable, the Social Security Administration will appoint a representative payee to manage that recipient's benefits. Under the Veterans Administration program (VA), the VA will appoint a fiduciary to perform a similar function. These appointments will be made even if the person has signed a power of attorney or trust.

Power of Attorney for Financial Affairs

A few decades ago, the power of attorney was a little-used device, but now it has become standard, signed by a significant percentage of Americans (English and Wolff, 1996). Under a power of attorney, a person, called a principal, grants to an agent or attorney-in-fact the powers as specified in the document. The powers granted may relate to healthcare or finances, although the practice in most states is to address finances and healthcare separately. Prior to the enactment of durable power-of-attorney stat-

utes, an agent could not be granted authority to act during any period that the principal was incapacitated. The purpose of the durable power-of-attorney statutes is to reverse this result and to permit a power of attorney to endure beyond the principal's incapacity. To be durable, the power must provide either that the agent's authority continues in effect despite the principal's incapacity (an "immediately effective" power), or must provide that the agent's authority springs into effect upon the principal's incapacity (a "springing" power).

Considerations for a Durable Power of Attorney

There are numerous drafting and counseling issues to consider when preparing a durable power of attorney.

Does the document contain the required language?

Most durable power-of-attorney statutes are patterned after the Uniform Probate Code, either the Code as approved in 1969 or the revised version completed in 1979 (English, 1992). Under the Uniform Probate Code, a power of attorney is not durable unless it contains language expressly indicating that the agent's authority continues despite the principal's incapacity, or will arise upon the principal's incapacity. Under the Uniform Power of Attorney Act, a model act, completed in 2006, that has been enacted in eleven states through 2011, powers of attorney are automatically durable unless the document says otherwise (Whitton, 2008).

What are the signing requirements?

The Uniform Probate Code imposes no signing requirements for a power of attorney other than for the principal's signature. Some state statutes are not so liberal. For example, Section 4121 of the California Probate Code requires that the power of attorney either must be notarized or signed by two witnesses. Despite the absence of specific signing requirements, it is advisable to have the principal's signature notarized. Notari-

zation increases the chance the power of attorney will be accepted. Notarization also is essential if the agent must record the power in the official land records in order to transfer title to the principal's real estate.

Which is better, an immediately effective power or a springing power?

The principal deterrent to the widespread use of springing powers is concern about acceptance of powers of attorney by banks, insurance companies, and other third parties. With a springing power, an extra element for third parties to ponder is introduced—a possible issue as to whether the principal is truly incapacitated. If the principal is not yet incapacitated, an agent under a springing power is without authority.

To counteract this concern, a springing power should always specify an internal procedure for determining the principal's incapacity. For example, the power might provide that incapacity is to be determined by the family physician in conjunction with the agent. The power of attorney should also provide that the third party accepting the power may rely on such a determination (Wentworth, 2003).

Use of an immediately effective power avoids this need to assess the principal's capacity, but can lead to situations where the principal and agent both have authority to act on the same transaction. The principal, while competent, may rescind the agent's authority but may not be able to undo transactions the agent has already implemented. It is critical to select an agent in whom the principal has confidence.

Should you use your state's statutory form?

A growing number of states are enacting so-called statutory short forms (English, 1992). The 2006 Uniform Power of Attorney Act contains such a form (Whitton, 2008). The name "statutory short form" is apt as the form consists primarily of a series of boxes to check. The powers of the agent granted by the particular check marks are then laid out in the under-

lying statute in extensive detail. Hopefully, using such a common form will promote third-party acceptance.

Have the agent sign an acceptance

An agent is not obligated to accept the position. Having the agent sign an acceptance in advance reduces the likelihood that the agent will decline when the need arises. Also, involving the agent in the process will encourage the principal to discuss his or her wishes with the agent, making the power a better fit with the client's needs.

Appoint successor agents

Given the significant chance that the originally named agent will be unable to act when the need arises, appointing successor agents is clearly necessary, but the 1988 Uniform Statutory Power of Attorney Act, in effect in several states including California, omits this vital provision (English, 1992).

Consider nominating the agent as guardian

Should a guardianship become necessary for some reason, the agent is likely the person whom the principal would want to serve as guardian. More importantly, nominating the agent as guardian will reduce the chance that a disgruntled family member will use a guardianship to thwart the agent's authority. In nearly all states, either by specific statute or judicial practice, the court will grant the ward's nominee a first preference to act as guardian.

Exercise great care in granting an agent authority to make gifts

There are many reasons why an agent should be granted authority to make gifts. By making gifts, the agent can facilitate Medicaid planning. Furthermore, estate tax savings from lifetime gifting can be dramatic. A durable power of attorney with gifting authority may be important to meet estate-planning goals (Tiernan, 1999).

But a liberal grant of gifting authority may invite abuse, so several questions should be

addressed (Tiernan, 1999). May the agent make gifts for the agent's own benefit, whether directly or in discharge of a legal obligation of support? Should the authority to make gifts be subject to an annual exclusion limit (\$13,000 annually per donee for gifts made in 2012)? Should gifts be limited to the principal's prior pattern of giving? Should all family lines be treated equally? Is the agent allowed to support family members, such as adult children, who are no longer legal dependents but who were being supported by the principal? Should the agent have authority to transfer assets to the spouse to make maximum use of Medicaid exemptions and allowances?

Deal with access to medical records

While an agent under a financial power of attorney is not empowered to make healthcare decisions, access to medical records may be necessary for a variety of reasons, such as to verify the accuracy of a medical bill. Many practitioners recommend the principal sign a separate Health Insurance Portability and Accountability Act (HIPAA) release granting the agent access to such records. Others recommend that specific authority to access medical records be included in the power of attorney (Evans, 2004; Shenkman, 2009).

Exercise care in naming co-agents

Ideally, only one agent should be acting at a time. Formally naming co-agents may make it impossible to make decisions if one or more of the co-agents is unavailable. The principal may certainly encourage the agent to consult with other specified individuals (e.g., siblings) in the hope they will reach a consensus decision, but such a provision is best presented in the form of a side letter, not in the power of attorney itself. Should the principal designate co-agents, take precautions. The power of attorney should specify whether the agents may act alone or must act together. Requiring that agents act together is more cumbersome, but may fulfill the checks and

balances desired by the principal in appointing co-agents (Whitton, 2007). An alternative is to provide that the agents must act together for certain key decisions but may act alone for more routine matters.

Will the power of attorney be effective?

Powers of attorney are sometimes refused by banks, insurance companies, and other institutions that hold the principal's assets. Sometimes they refuse because of unfamiliarity with the power of attorney device, and sometimes it is over concern that the power of attorney is invalid or may have been revoked.

Be aware of the potential for abuse

Agents are responsible for their actions and can be held liable for mismanagement. But if the principal lacks capacity to monitor the agent's actions, the ability to hold the agent to account is of little value if the money is already gone. One way to reduce the risk of abuse is to require that the agent periodically report to another party, such as a family member (Tiernan, 2005). Great care should also be taken in selecting an agent and in educating the agent in his or her responsibilities.

Specify fiduciary standards

An agent is a type of fiduciary and is potentially liable for negligence or failure to act in the principal's interest. The durable power-of-attorney statutes in most states are quite brief and fail to specify fiduciary standards to guide the agent's conduct. The Uniform Power of Attorney Act specifies detailed standards, addressing such matters as conflict of interest, the obligation to keep financial records, the relationship of the agent with the agent empowered to make healthcare decisions under a healthcare power of attorney, and the obligation to preserve the principal's estate plan (Whitton, 2008). In states that have not yet enacted the Uniform Act, the drafter may

wish to consult the Act as a source for fiduciary standards to include in the power-of-attorney document.

Revocable Living Trust

A trust is a device under which the creator of the trust (the "settlor") transfers assets to a trustee to manage on behalf of beneficiaries. If the trust is revocable, the settlor may revoke the arrangement at any time and have the assets returned. The term "living trust" is not a legal classification but a non-technical term used to describe a revocable trust under which the settlor is the primary beneficiary and is usually the trustee as well. The primary purpose of a living trust is to avoid the probate process at death. But the living trust can also be an effective incapacity-planning device.

Agents should sign an acceptance form to reduce the likelihood they will decline to do the job when the need arises.

The settlor will usually be the principal beneficiary for life. Following the settlor's death, the trust assets will be distributed by the trustee to family and others in a manner similar to how the settlor would have provided by will, but without the need to go through the probate court. Because many settlors fail to transfer all of their assets to the trust, it is customary and highly recommended that the settlor also sign a will with a "pour-over" provision. The effect of the pour-over provision is to add to the trust any assets that must pass through probate court. That way one achieves unified management of the assets but loses the advantages of avoiding probate.

In order for the trust to be an effective incapacity-planning device, it must be fully funded. A trustee may act only with respect to assets transferred to the trust. Because settlors often fail to fully fund their trusts, it is recommended the settlor also sign a power of attorney autho-

ricing the agent to make such transfers to the trust. But the signing of a power of attorney is recommended even if the settlor fully funds the trust. Certain powers, such as the power to sign tax returns and represent the principal in tax matters, can be exercised by an agent, but would normally not be within the trustee's authority. Express authority to sign tax returns and otherwise handle the principal's tax matters should always be included in a financial power of attorney.

Key to the success of a revocable living trust is an effective provision for the appointment of a successor trustee: merely listing the name of the successor trustee in the trust instrument is not sufficient. The trust document should contain its own internal procedure for removing the trustee and appointing a replacement. This will avoid the need for a court proceeding to remove the trustee should the trustee become incapacitated.

Considerations for Living Trusts

Living trusts can be oversold. For some individuals, avoiding the probate process is not a major concern. For others, the power of attorney may be as effective an incapacity-planning device as a trust. The following are some questions an individual should consider before creating a living trust (Engel, 2002):

How necessary is it to avoid probate? The costs and difficulties of probate vary from jurisdiction to jurisdiction. In states with cumbersome probate systems, living trusts are common. In states with simpler probate procedures, living trusts are less common.

How much will the living trust cost? Revocable trusts are more expensive to create than a will because of the need to transfer assets to make the trust fully effective. Should the settlor fail to fully fund the trust, savings on probate will not offset the costs of creating the trust, because assets not transferred to the trust will have to go through probate.

Might probate be avoided by use of other property arrangements? Many individuals,

particularly those in a marriage who wish to leave assets to the surviving spouse, can avoid probate through the use of devices that automatically transfer title to a survivor at death. These include joint ownership, payable-on-death arrangements, and beneficiary designations on life insurance and retirement plans. They are much easier and less expensive to create and administer than a living trust.

Appointing a guardian can intrude on personal liberties, and is never a step to be taken lightly.

What is the advantage of the revocable trust over power of attorney? Banks, insurance companies, and other institutions that hold the principal's assets sometimes refuse powers of attorney. Often they refuse because of concern that the agent lacks authority to transact with respect to the principal's assets, which are nearly always titled in the principal's name. In the case of a trust, because the assets are titled in the name of the trustee (and not in the principal's name), refusal of trustee authority is rare.

Representative Payee

Whenever the Social Security Administration determines that it is in the interest of a Social Security recipient, it may appoint a representative payee to receive and manage the recipient's benefits. It is within Social Security's discretion to select a payee, although Social Security gives preference to a court-appointed guardian, spouse, parent, or other relative. Friends, institutions, and social service agencies are also sometimes appointed. Agents under a power of attorney are not on the priority list, although agents will often qualify as payees because they are close family. A recipient who wishes a particular person as payee should inform Social Security (Regan, Morgan, and English, 2011).

A representative payee must use the benefits received to promote the recipient's interests,

which will usually include current maintenance and, if needed, institutional care. Representative payees must file annual statements with Social Security describing how benefits were spent. But such statements are rarely audited and mismanagement by representative payees has long been a concern. Social Security is not normally required to reimburse for a payee's misappropriation (GAO, 2011).

The Veterans Health Administration (VA) also authorizes the appointment of a payee to receive benefits on behalf of a VA beneficiary, but the representative in this instance is called a “fiduciary,” not a “payee.” The procedures for appointment and the authority of a VA fiduciary are broadly similar to those for a

representative payee. Similar concerns about mismanagement have also been raised about VA fiduciaries (GAO, 2011).

Guardianship

The appointment of a guardian or conservator is the law's traditional answer when an adult can no longer make his or her own decisions. A guardian may be appointed to make personal decisions, to manage property, or both. In many states, the term “conservator” instead of “guardian” is used to refer to the person appointed by the court to manage the individual's property. In a few states, guardians are appointed only for minors; conservators of the person or estate are appointed for adults. The appointment of

Is Guardianship the Right Step?

Before recommending that someone seek guardianship, the following factors should be considered:

Is guardianship necessary?

There are numerous alternatives to guardianship. Perhaps the person for whom guardianship is sought no longer has capacity to sign a durable power of attorney or revocable living trust, but there are many informal alternatives. More intense use of community services or increased family involvement can help to avoid guardianship. Sometimes the individual merely needs help in bookkeeping. For many married couples, automatic deposits of an incapacitated person's funds into a joint bank account will give the other spouse effective control without the need to seek guardianship.

Is the proposed guardian capable of handling the job?

Family members are usually chosen as guardian, but the job of guardian is not a simple one. Before petitioning for the appointment of a guardian, consider whether the proposed guardian has sufficient integrity and is equipped both emotionally and technically for the job. For those without adequate technical knowledge, look into training resources (GAO, 2010).

Is a limited guardianship appropriate?

A majority of state statutes authorize the appointment of limited guardians. A limited guardian has some but not all of the powers of a full guardian. The court order of appointment will usually specify exactly which powers have been granted to the limited guardian. Despite limited guardianship's widespread availability, the procedure is rarely used (Frolik, 2002). Appropriate cases often are not brought to the court's attention. In addition, many courts are reluctant to commit limited judicial resources to the oversight and monitoring of limited guardianships. This is particularly the case in situations where it is expected that the person under guardianship will continue to decline in capacity and it will be necessary to periodically adjust the guardian's powers.

a guardian, which may entail considerable expense and intrudes on personal liberties, is never a step to be taken lightly.

The Need for Review

Advanced planning documents should be periodically reviewed. Powers of attorney should be reviewed at least once every five years and upon other key events, such as a divorce or a person's significant decline. Individuals should

also remain in regular contact with their designated agent and trustee so that when the need arises, the agent and trustee will be fully informed and prepared to undertake this significant responsibility. 

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