Morgan Stanley

Foundational Estate Planning Documents

Wealth and Estate Planning Strategists
Family Office Resources

Basic estate planning allows all individuals, regardless of their level of wealth or family situation, to plan not only for how assets are disposed upon death, but for other relevant decisions such as delegation of medical and financial decision-making in case of incapacity and appointment of legal guardians for minor children or dependents. These arrangements can be made by creating one or more foundational estate planning documents, which typically include a Health Care Proxy, a Health Care Directive /Living Will, a Power of Attorney, a Last Will and Testament, and a Revocable Trust. Without these foundational documents, it may be necessary to involve the courts to address these issues, which could result in additional costs, delays, and uncertainty. This article provides an overview of the importance of each of these documents and a few alternatives.

Health Care Decisions

When a person becomes incapable of managing their medical or personal care, a court proceeding is generally necessary to appoint a guardian or conservator to care for the person, in the absence of other arrangements. To prevent this process, a medical decision-maker can be appointed with a Health Care Proxy and medical wishes can be articulated with a Health Care Directive (also known as a Living Will). In some states, a Health Care Proxy and Living Will may be combined into a single document.

Health Care Proxy

- A Health Care Proxy is a document by which you authorize another individual (your "agent") to make health care decisions for you in the event of your incapacity or inability to communicate.
- The Health Care Proxy becomes effective only if you become incapable of making your own health care decisions and remains effective only until you regain capacity or at your death.

With a Health Care Proxy, you appoint the person who will make your health care decisions, and with a Health Care Directive, you express your treatment preferences.

- You can revise your Health Care Proxy at any time to change your agent. It is important for your agent to have a copy of the Health Care Proxy in case of an emergency.

Health Care Directive / Living Will

- A Health Care Directive / Living Will is a document used to express your intent or preferences regarding health care matters, including the withholding or withdrawal of life-sustaining medical treatment and artificial nutrition and hydration.
- A Health Care Directive / Living Will can provide guidance to the agent you name under your Health Care Proxy (though speaking about your wishes with your health care agent is the best guidance) or to your medical providers if you have no health care agent. It often includes broad language intended to cover unanticipated situations or new treatments.
- Under the Health Insurance Portability and Accountability Act ("HIPAA"), a privacy waiver may be required for physicians and hospitals to share medical information with your health care agent in an emergency. This waiver may be a separate document, but it is often included in the Health Care Directive / Living Will.
  - **Note:** The HIPAA privacy waiver could also cover information needed by your attorney-in-fact, a role discussed below, to arrange for medical payments.
- If you executed a Health Care Proxy and a Health Care Directive / Living Will, your health care agent is generally required to act in accordance with your wishes, but state law varies.

Management of Assets

Besides healthcare decisions, as described above, it is also important to address the management of your property and financial affairs in the event of incapacity. If no arrangements are in place, a court proceeding may be required to appoint a guardian or conservator of your property and finances. You can generally avoid such a court proceeding by (1) having a Power of Attorney in place to name someone to manage the assets titled in your name and/or (2) transferring your assets into a trust and appointing a trustee, or successor trustee, to manage those assets during your incapacity according to the terms of the trust agreement. In some cases, you may wish to have both arrangements in place.

Power of Attorney

- A Power of Attorney is a document by which you (the "principal") appoint another person (your "agent" or "attorney-in-fact") to act on your behalf with respect to property titled in your name. Your agent steps into your shoes to exercise the powers you grant, your attorney in-fact makes financial decisions for you, and must act as a fiduciary and only take action that is in your best interest.

- A Power of Attorney may be either immediately effective or "springing." State law varies on whether "springing" Powers of Attorney are valid.
  - A Power of Attorney may be effective immediately upon execution, meaning that your agent can act on your behalf even if you are not incapacitated. This could be useful in case you cannot attend to a matter in person, such as if you are traveling, and allows your agent to act more quickly on your behalf.
  - A springing Power of Attorney comes into effect at a specified future time or upon the occurrence of a specified event, such as your incapacity or disability. A springing Power of Attorney requires a determination that the specified event, such as your incapacity, has actually occurred (for example, by obtaining physician certifications), which could result in a delay in your agent's ability to act.
- A Power of Attorney can be "durable" or "non-durable." A durable Power of Attorney is not impacted by whether or not you have capacity and may either be immediately effective or springing. A non-durable Power of Attorney, in contrast, may only be used while you have capacity and becomes invalid if you are incapacitated.
- A Power of Attorney terminates at your death, as does any authority that was granted to your agent.

Revocable Trust

- Another way to manage assets in case you become incapacitated is by setting up a trust, which is a fiduciary relationship between you, the original owner of the assets (called the "settlor", "grantor" or "donor"), and a "trustee" you select (either an individual or a corporate professional) to manage certain property according to the directions included in the trust agreement and for the benefit of beneficiaries you specified in the trust agreement.

In the event of incapacity, the assets in a Revocable Trust would be managed by a successor trustee. Assets not transferred to a trust and that continue to be held in your own name would be managed by an attorney-in-fact pursuant to a Power of Attorney. It is possible to name the same individual to serve as both attorney-in-fact and successor trustee of the Revocable Trust.

- A "revocable" trust is a trust that you, as donor, create during your life that you can change or terminate at any time, and of which you are typically the trustee and sole beneficiary. The trust agreement usually contains directions regarding the management of the trust assets under different circumstances, including during incapacity and after your death, and generally becomes irrevocable after your death.
- If you establish a Revocable Trust and fund it with assets, you can continue to fully control and enjoy the trust assets during your life. If you become incapacitated, you would be replaced as trustee by a successor trustee that you select, who will be bound by the instructions contained in the trust agreement regarding how to manage and distribute the trust assets during your incapacity and after your death (for example, directing the trustee to pay for your healthcare or for the expenses of your family members).
- Since the trust assets can continue to be managed by a successor trustee if you are incapacitated, it is less likely that a court would need to appoint a guardian/conservator of your estate, thereby avoiding the expenses and potential delays of a court proceeding.

Disposition of Assets Upon Death

When an individual dies without a Last Will and Testament (a "Will"), also known as intestacy, the assets owned in the decedent's individual name (and without a beneficiary designation) will be disposed of according to a "default" plan established under the rules of intestacy under applicable state laws. The court appoints an "administrator" to take charge of the estate, pay all debts, and then distribute the remaining assets to the individual's heirs as determined under applicable state law. A Will allows an individual to direct how to dispose of assets upon death and to appoint their preferred person as the executor/personal representative to manage the estate and carry out their wishes. Alternatively, transferring assets to a trust is another way to control how, and by whom, assets are managed and disposed after death.

The estate of an individual who dies intestate without a Will is managed by "administrators" appointed by a probate court and distributed according to state law. In contrast, an individual who makes a Will may nominate their preferred executors or personal representatives to manage the estate and the executors/ personal representatives must distribute the estate according to the directions in the Will.

Will

- A Will is a document which disposes of your property at death in accordance with your wishes and names an "executor" to carry out your directions. A Will can be revoked or changed at any time during life by an amendment called a Codicil or by a later Will.
- For the Will to be effective, it must be signed with certain formalities, as determined under applicable state law, and the validity of the Will must be proven in a judicial process known as Probate. The probate process may make the Will available to the public and, in certain circumstances, probate can be lengthy and expensive.
- Property passing by Will is called "probate property" and generally includes property you own and hold title to at your death, either individually or as tenant-in-common, and your share of any community property not already retitled.
- Your Will does not control the disposition of property to which you do not hold title individually (for example, assets held in joint name with right of survivorship with another person or property you transferred to a trust) or property transferrable by beneficiary designation (for example, certain bank or retirement accounts, or life insurance policies).

Guardian for Minor Children

A Will is a very important document for parents with minor children as it is the document where individuals nominate a guardian(s) for minor children in the event both parents are not alive. Typically, a court will approve the nominated guardian if there is no reason such person cannot act in the children's best interest. Failing to nominate a guardian in a Will can lead to unanticipated results, including the possibility that a court ultimately selects the guardian(s) for minor children without any parental input.

Testamentary Trust

- In case you do not want your assets to be distributed immediately and directly to beneficiaries upon your death, you can create a testamentary trust under your Will. By doing so, upon your death and after completion of the probate process, the property will be transferred to a trustee to manage, invest, and administer the property for the benefit of your designated beneficiaries according to instructions under your Will, rather than passing directly to the beneficiaries themselves.

Testamentary Trust vs. Revocable Trust:

- **Both types of trusts allow you to name a trustee to manage assets and control who will receive the assets upon death.**
- **A Testamentary Trust is part of a Will; thus, it must go through probate to be effective, with the associated costs, potential delays, and potential publicity.**
- **For a Revocable Trust, the probate process can be avoided, but assets must be retitled in the name of the trust and transferred to the trust during the lifetime of the donor while the donor has capacity.**

- This could be an option especially for minors, young adults, or other beneficiaries who may not be ready to manage their own assets. Testamentary Trusts are also utilized in more advanced estate planning strategies to achieve various objectives. Trusts created under a Will remain subject to probate court supervision, and subject to attendant fees and expenses. Additionally, the Testamentary Trust provisions could become public once the Will is filed with the court.

Revocable Trust

- As discussed earlier, a Revocable Trust (or Living Trust) allows you, as trustee, to manage and control assets while you are living (and by your successor trustee during incapacity) and direct how the trustee or successor trustee will distribute the trust assets after your death.
- On your death, your Revocable Trust becomes irrevocable and the trust provisions will govern the management and distribution of the trust assets after your death. In contrast to a Will, a Revocable Trust and assets already held in trust at the time of death avoid the probate process and, therefore, the trust, and provisions regarding how and to whom you dispose of your property, remain private and are not subject to court supervision.
- From an investment perspective, without the delays associated with a probate proceeding, the successor trustee appointed under your trust agreement can take control of your assets quickly, which can be particularly useful if you own assets that require timely management, such as a concentrated and volatile equity position. Your Will can also name your Revocable Trust as a beneficiary for any assets not already transferred to the trust (a “pour-over Will”). This would allow the assets of your estate to flow to, and be managed and disposed of, according to the terms of your Revocable Trust once your Will has been probated.

Gift and Estate Tax Considerations for Estate Planning

In addition to the above-described benefits, depending on the specific circumstances of each individual, a carefully designed estate plan can help optimize the manner in which your estate is managed and distributed, and take into consideration strategies that impact federal and state estate and gift taxes and the generation-skipping transfer tax.

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