Morgan Stanley

PRIVATE WEALTH MANAGEMENT

Foundational Estate Planning Documents

Overview

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 executing one or more of the so called "foundational estate planning documents," which usually include a Health Care Proxy, a Health Care Directive / Living Will, a Power of Attorney and a Last Will and Testament. Without these foundational documents, it may be necessary to involve the courts to address these issues, which would result in additional costs, delays and uncertainty. In this article we will go over the importance of each of these documents and a few alternatives.

Arrangements for Making Health Care Decisions

When a person becomes incapable of managing his or her 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, you can appoint a medical decision-maker with a Health Care Proxy and articulate your medical wishes 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.

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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.

> ***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 preferences regarding the treatments you wish to receive.***

- 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.
- 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 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/attorney-in-fact steps into your shoes to exercise the powers you grant; your attorney-in-fact makes decisions in place of you and must act in your best interest.
- A Power of Attorney can be "durable" or "springing." State law varies on whether "springing" Powers of Attorney are valid.
    - A durable Power of Attorney is 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. The authority of your agent under a durable Power of Attorney continues if you become incapacitated.
    - 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 may mean a delay in your agent's ability to act.
    - A Power of Attorney terminates at your death, as does any authority that was granted to your agent/attorney-in-fact.

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" or "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 the donor can change or terminate at any time, and which the donor is typically the trustee and sole beneficiary. You can change or terminate the trust at any time. The trust agreement usually contains directions regarding the management of the trust assets under different circumstances, including incapacity and after your death and generally becoming irrevocable after your death.

- If you establish a revocable trust and fund it with assets, you could 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 and/or for the expenses of your family members).

- Therefore, because the trust assets can continue to be managed by a successor trustee, there would be no need to apply to a court to name a guardian/conservator of your estate thereby avoiding the expenses and potential delays associated with the appointment of a guardian/conservator.

DISPOSITION OF ASSETS UPON DEATH

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

When an individual dies without a Last Will and Testament (a "Will"), also known as intestacy, the assets titled in his or her name (and without a beneficiary designation) will be disposed of according to a "default" plan established under appliable state laws. The court would appoint an "administrator" to take charge of the estate and pay all debts and then distribute all remaining asset to the individual's heirs. A Will allows an individual to direct how to dispose of assets upon death and to appoint the person to manage the estate and carry out his or her wishes. Alternatively, transferring assets to a trust is another way to control how, and by whom, assets are managed and disposed after death.

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 by state law, and its validity must be proven in a judicial process known as Probate upon your death. This process may make the Will available to the public and in certain circumstances could 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 operate over 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 insurance policies).

A Will is a very important document for parents with minor children as it is the document where individuals nominate a guardian(s) for such children in the event the other parent is 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 can lead to unanticipated results, including the possibility that a court ultimately selects the guardian(s) without any parental input.

Differences between a testamentary trust and a revocable trust:

Both types of trusts allow you to name a trustee to manage assets and control who will receive the assets upon death.

- ***However, 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 disadvantages of the probate process can be avoided, but assets must be retitled in the name of the trust and transferred during the lifetime of the donor while the donor has capacity.***\

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.

- 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 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 "pourover Will"). This would allow the assets of your estate to flow to, and be managed and disposed of, according to the trust agreement once approved under the probate process.

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 to optimize the manner in which the estate is managed and distributed and taking into consideration strategies that consider the federal and state estate and gift taxes, and the generation-skipping transfer tax.

Important Disclosure

Morgan Stanley Smith Barney LLC does not accept appointments, nor will it act as a trustee but it will provide access to trust services through an appropriate third-party corporate trustee.

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