

Pathways

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ASK AN EXPERT

How do we plan for the possibility that we will become unable to manage our own finances?

Although nobody likes to contemplate becoming unable to manage financial affairs, the failure to plan for that possibility can be costly. Fortunately, incapacity planning is easy and inexpensive.

The best way to plan for financial incapacity is to make a revocable living trust the centerpiece of your overall estate plan. Most of us should have a living trust in any event, simply to avoid probate of our estates. A trust includes a designation of successor trustees to take over management of the trust assets when the settlor is no longer able to serve as trustee. So long as your major assets are held in the trust, the succession of trustees provided in the trust instrument will provide a substitute asset manager for the bulk of your estate whenever you are no longer able to manage your finances. Most people name a family member or trusted friend as successor trustee. You should consider naming more than one successor, if possible. Depending on your situation, you may wish to name a bank, trust company, or other institution as a successor trustee.

While a trust is the best starting point to incapacity planning, it is seldom sufficient by itself. You should also execute a general power of attorney in favor of a trusted family member or friend. A power of attorney will enable someone else to handle on your behalf miscellaneous financial matters of all kinds that do not relate to your trust assets and are therefore beyond the scope of your living trust. A power of attorney, in its usual form, is an extremely broad grant of authority, and rules governing accountability of agents are not as strict or as well-defined as they are for trustees. Therefore, you should deeply trust anyone to whom you grant a power of attorney.

The law does provide a way to manage the financial affairs of incapacitated people who have not properly planned for incapacity. That mechanism is a court-supervised conservatorship, and it is cumbersome, intrusive, and expensive. Planning proactively for incapacity, by means of a trust and a general power of attorney, is vastly superior to the alternative of forcing your family to resort to a conservatorship.

– Jim Deeringer



The general information in this newsletter may or may not be appropriate for your particular situation. Before taking any action based on this newsletter, you should consult with your estate planning attorney.



Roth IRA Conversion Opportunity

A Roth IRA is a retirement vehicle that allows individuals to contribute after-tax dollars to an account which will then grow tax-free and be distributed tax-free. In prior years, many high-income taxpayers were prohibited from converting a Traditional IRA to a Roth IRA due to the income restrictions. Beginning this year, the income restrictions have been lifted allowing taxpayers of all income levels to convert a Traditional IRA to a Roth IRA. Any portion of the converted amount that has not yet been taxed will be taxed in the year of conversion as ordinary income. For conversions completed this year, taxpayers may elect to have the taxable portion of the conversion equally split between the 2011 and 2012 tax years.

Conversion to a Roth IRA offers a unique estate planning opportunity. Because there are no minimum distribution requirements, Roth IRA assets are able to grow tax-free longer, which may lead to greater wealth accumulation and more assets available for beneficiaries and heirs. Moreover, beneficiaries will have the option to take distributions from the IRA over an extended period of time, thereby allowing the account to continue to grow tax-free during the lifetimes of the beneficiaries. Additionally, the payment of tax liability now reduces the size of the taxpayer's gross estate for estate tax purposes.

If you are interested in converting an eligible retirement plan to a Roth IRA, please consult with your financial advisor or estate planning attorney to determine if it is right for you.

– Kelly Tiberini



Plan Now to Avoid Capacity Challenge Later

We are fortunate to live in a time of increased longevity. A 65-year-old living in the United States today has an average lifespan of nearly 20 years. As we live longer, however, more of us will experience, and have loved ones who experience, a decline in mental capacity.

A comprehensive estate plan ensures that our desires are carried out during our lifetimes and afterwards. From a legal perspective, the key is to create and update our plans while we have the mental capacity to do so, rather than deferring the expression of our desires until our capacity may be challenged.

California law presumes that we all have the mental capacity to engage in estate planning. A person who chooses to contest a will has the burden of proving by a preponderance of the evidence, in the probate department of the Superior Court, that the document is invalid. (The same standard applies to both wills and trusts.)

Evidence of eccentricity will not overturn a will. Instead, the contestant must show that the testator, i.e., the maker of the will, lacked sufficient mental capacity to be able to (1) understand the act of creating a will, (2) understand and recollect the nature and situation of her property, or (3) remember and understand her relations to her living relatives and to those whose interests are affected by her will. The judge will look beyond any diagnosis of mental illness and assess whether the contestant has proven a deficit in at least one specific mental function.

Alternatively, the contestant must show that testator suffered from delusions or hallucinations that actually influenced the disposition of property. For example, an individual who believes she shares her house with spirits has capacity unless her will provides that the spirits, as opposed to her flesh-and-blood relatives, are to inherit her property.

Mental capacity is assessed as of the moment that the testator signs her name to the document. Very often, by the time the will is challenged, many years have elapsed, and recollections of the testator's condition when she executed the will have dimmed.

Medical records can play an important role when courts resolve capacity questions. Records document the patient's condition on specified dates and may reveal significant progressions in the patient's condition. The patient, or the patient's relatives and friends, may have reported memory loss, disorientation, or other problems. However, the records often do not provide a crystal clear answer to the legal question of whether the patient had capacity to make a will.

Doctors diagnose and treat patients, aiming to improve the quality of their day-to-day lives. They do not ask their patients if they understand the significance of a will, if they know what real estate they own, or if they can name their next of kin. Instead, doctors use diagnostic tools, such as the Mini-Mental State Examination, to take a measure of cognitive function.

Accordingly, there is frequently a disconnect between the legal criteria for mental capacity and the factual information in the testator's medical records, leaving room for lawyers and expert witnesses to debate competing positions. In such disputes, the contestant often also argues that, even if the testator had sufficient mental capacity to make a will, her condition left her vulnerable to undue influence by another, such that the will does not reflect the testator's own true desires. Undue influence is a form of coercion that, if proven, invalidates a will.

Ultimately, a judge has to hear the evidence and decide whether the challenger has proven that the testator lacked sufficient mental capacity to execute the document in question or was a victim of undue influence. When the evidence is mixed, taking the case all the way to trial is an expensive endeavor with an uncertain result, so many contests are resolved by way of negotiated compromise between the parties rather than a court decision.

The point is this: by proactively making our estate plans when we are in good health, we can gain peace of mind by minimizing the possibility of future challenge to them.

– Jeff Galvin



Alzheimer's Disease and Estate Planning

As we live longer, Alzheimer's disease is becoming more prevalent and thus is more frequently an issue in estate planning. Alzheimer's, the leading cause of dementia, is a progressive brain disease that is often first revealed by short term memory loss. At some point as Alzheimer's progresses, a person loses the mental capacity to make (or revise) a will or trust. The Alzheimer's Association estimates that 5.3 million Americans have the disease and that one in eight individuals aged 65 and older have the disease. For more information, see www.alz.org.

Estate Planning Can Be Funny!

How about a little humor? Believe it or not, there are some funny estate planning jokes out there, and they are not all about the lawyers! Here are two of the best we have heard lately.

#1: Bad Financial Advice - Counting Your Eggs Before They Hatch

Dan was a single man living at home with his father and working in the family business. When he found out he was going to inherit a fortune when his sickly father died, he decided he needed a wife with whom to share his fortune. One evening at an investment meeting he spotted the most beautiful woman he had ever seen. Her natural beauty took his breath away. "I may look like just an ordinary man," he said to her, "but in just a few years, my father will die, and I'll inherit \$20 million." Impressed, the woman obtained his business card and three days later she became his stepmother.

#2: Trust But Verify - Be Careful When Selecting a Fiduciary

A wealthy old man summons to his bedside his doctor, his priest, and his lawyer. "They say you can't take it with you, but I'd like to have something with me, just in case. So I am giving each of you an envelope containing \$100,000 in cash and I would be grateful if at my funeral you would put the envelopes in my coffin." They each agree to carry out his wish.

At the old man's funeral, each of the three advisors slips something into the coffin. As the three are walking away together, the doctor turns to the other two and says, "Friends, I have a confession to make. At the hospital we are desperate for a CAT SCAN machine, so I took \$20,000 of our friend's money for a new machine and put the rest in the coffin as he asked." The priest admits, "I, too, have a confession to make. I took \$50,000 for our homeless fund and put the rest in the coffin as our friend requested." The lawyer righteously replies, "I am astonished that you would treat so casually our undertaking to our friend. I want you to know that I placed in his coffin my personal check for the full \$100,000."



– Gina Lera

Please let us know if you have an estate planning joke to share. We may feature it in an upcoming issue of this newsletter.

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50 Years!



Jim Willett passed the California bar exam in 1960 and joined Downey Brand the following year. Hats off to Jim for his five decades of service to clients and the firm!