Durable Powers of Attorney

By Richard S. Franklin and Lester B. Law

We are passionate about achieving good results for our clients. One way that we do this is by ensuring that their durable powers of attorney (DPOA) are up to date. As a refresher, a DPOA is a device used to authorize another person (the "Agent") to manage the financial affairs of the person granting the power of attorney (the "Principal"). Without using this tool (or other similar tools), in the event that the Principal becomes incapacitated, an expensive and invasive, court-monitored guardianship proceeding may be needed to authorize someone to act on the Principal's behalf. Therefore, we recommend that all of our clients have this important document and that it be reviewed frequently to determine whether any revisions are necessary.

To determine whether updating a DPOA is appropriate, we often begin by reviewing the document to determine how long ago it was signed and the governing law. Substantively, we typically turn first to the provision authorizing gifts to see if it's adequate. If this single provision is insufficient, we will recommend replacing the document.

It is important to understand that state law does not automatically grant the Agent authority to make gifts under a DPOA.[1] Moreover, because unauthorized gifts can be recovered, the Internal Revenue Service (IRS) will ignore gifts for tax purposes unless the Agent has proper authority to implement such gifts.[2] Therefore, the DPOA should have language specifically granting the power to make gifts to the extent desired. Authorizing the Agent to make gifts on behalf of the Principal, if he or she becomes disabled, is critical to achieving some of the more important objectives, as follows:

1. Gifts to Help Family Members. Suppose the Principal had been making small payments to all college-aged nieces and nephews to assist with college expenses. The gifts must cease upon the Principal's incapacity unless the Agent is granted authority to continue the gift program.

2. Annual Exclusion Gifts to Save Federal Estate Taxes. Congress allows each individual to give $14,000 per year to an unlimited number of other individuals (this is the so-called "annual gift

[1] Under Section 201(a)(2) of the Uniform Power of Attorney Act, the DPOA must specifically grant the authority to make gifts. Florida, which adopted its own version of the uniform law, went further and provides in Fla. Stat. § 709.2202 that the authority to make gifts must be initialed by the Principal. Moreover, under the uniform law, if general authority to make gifts is granted to the Agent, the rules limit such general gift making authority to annual exclusion gifts (i.e., currently $14,000 per person, per year). Pursuant to Va. Code Ann. § 64.2-1614(C), if the DPOA does not grant the authority to make gifts, the family is not without options, however, it requires a petition to a court of competent jurisdiction to determine whether the Agent may make gifts provided that such gift-making is not inconsistent with the DPOA. Of course, that is not a great solution because it throws the family back in the expensive court process the DPOA was designed to avoid! And, a court may determine that the process may only be allowed one year at a time, thus, requiring multiple visits and additional costs!

[2] *See* Est. of Goldman, T.C. Memo, 1996-29 (1996)(The court rejected the estate's claims that the transfers were valid gifts: "The purported gifts fail due to an absence of clear and convincing evidence of decedent's intent and [the Agent's] lack of authority to make a gift." Accordingly, the court found the purported gifts were includable in the gross estate for estate tax purposes.); Est. of Sharp, T.C. Memo, 1994-636 (1994).

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tax exclusion")[3] without using any of the $5.49 million gift and estate tax applicable exclusion amount (we can refer to as the "exemption amount").[4] Once the total of an individual's lifetime taxable gifts (which are those gifts to an individual in a particular calendar year in excess of the annual gift tax exclusion) and the assets in his/her gross estate for federal estate tax purposes exceed $5.49 million, lifetime and testamentary transfers are subject to gift/estate tax at a rate of 40%. By making annual gift tax exclusion gifts, the individual is, in effect, reducing his or her remaining taxable estate without any gift/estate tax implications! Therefore, an individual with an estate over the $5.49 million threshold saves $5,600 in estate taxes for each $14,000 gift made during lifetime ($14,000 x 40%). If the individual has 10 possible family members to whom he/she can give annual exclusion gifts, he or she would save $56,000 in estate taxes by making total annual exclusion gifts of $140,000. If this is undertaken on an annual basis, then, over a number years, using this strategy can save significant estate taxes. However, such gifts to family members must end upon the Principal's incapacity, unless the DPOA specifically grants the Agent the authority to continue the annual gift tax exclusion program. If the Agent makes unauthorized annual gift tax exclusion gifts, the IRS will still impose estate taxes on the lifetime gifts upon the Principal's death.[5]

3. Applicable Exclusion Gifts to Save Estate Taxes. More sophisticated gift strategies can also be used to save estate taxes. Many of these strategies involve using a portion of or all of the $5.49 million gift/estate tax exemption amount during lifetime. Like making annual gift tax exclusion gifts, these strategies will not be available if the Principal becomes incapacitated and the Agent is not properly authorized to make such gifts under a DPOA.

4. Gifts that Trigger Gift Taxes. In transferring large amounts of wealth to subsequent family generations (i.e., amounts in excess of the $5.49 million exemption amount), the gift tax is 28.6% less expensive than the federal estate tax. This is because gift taxes are only paid on the value of the gift, but estate taxes are paid on the entire estate, including the part of the estate that represents the actual estate taxes. Again, during the Principal's incapacity, the strategy of making large taxable gifts (i.e., because they are more efficient) will be unavailable if the Agent is not properly authorized under a DPOA.

5. Gifts to Save State Estate Taxes. In the local area, both the District of Columbia and Maryland impose a separate estate tax. This tax is in addition to the federal estate tax. However, neither the District nor Maryland impose a gift tax. Therefore, the District and Maryland estate taxes can be avoided by making gifts during lifetime, rather than transfers upon death. Even

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[3] The $14,000 amount is indexed for inflation and will likely increase to $15,000 in 2018.

[4] The $5.49 million gift tax and estate tax exclusion is also indexed for inflation.

[5] *See* PLR 9410028 (December 10, 1993). In this ruling, the decedent had made annual gifts to his children and grandchildren for many years. Six weeks before death, the decedent made checks to complete the gifts in the year of death. However, he became incapacitated prior to delivering the checks (i.e., before the gifts were completed). After his incapacity, his Agent issued replacement checks and made additional gifts. According to the IRS, numerous courts have held that gifts by an Agent are void when the power of attorney does not expressly grant the Agent the power to make gifts. The DPOA in this ruling did not expressly permit gifts. The IRS refused to infer that power under Colorado law, and therefore it found that the transfers under the DPOA were not valid gifts and were subject to estate taxes upon the decedent's death.

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deathbed gifts will achieve this result.[6] However, again, this planning strategy will be unavailable if the Principal is incapacitated and the Agent is not properly authorized under a DPOA.

6. Gifts to Continue Charitable Gifts. Clients frequently make annual gifts to religious institutions, colleges, museums and theatres, etc. If the Principal's desire is to have the gifts continue during incapacity, the DPOA must grant the Agent the authority to do so.

7. Predeath Gifts to Achieve Income Tax Deductions. Frequently, individuals make charitable gifts in their wills and revocable trusts. These gifts usually are structured to take place upon the individual's death. There is an unlimited deduction from estate taxes (Federal and state) for testamentary transfers to charity. For example, suppose John has a provision in his will giving his college $10,000 upon his death. The $10,000 bequest will not trigger any estate taxes to John's estate. However, if John is sick and expected to die, a better tax result is achieved by advancing the $10,000 to the college while John is still alive. The lifetime gift allows John a $10,000 income tax deduction, which could reduce John's income tax liability (i.e., save money for the family). The college receives the same amount, just a bit sooner, which it will appreciate. The college should agree that the lifetime gift is in lieu of the transfer upon death, so there is no doubling up on the $10,000. Following the lifetime gift, the $10,000 is no longer part of John's estate and, even though John's estate would not have paid any estate taxes on this amount as it would have passed to charity, John will have received the income tax benefit during his life. If John is incapacitated and the DPOA does not properly authorize the Agent to make such gifts, this valuable strategy is unavailable too.

The examples above are just a few situations in which gifts can achieve better results than transfers upon death and they illustrate why DPOAs should contemplate such planning. There are many more such situations than we can identify here. Moreover, as new strategies become available and as the income, estate and gift tax laws change, we are constantly thinking of new situations and techniques that are potentially available if the DPOA is adequate. That partially explains why we often recommend updating the DPOAs that we prepared from a few years ago.

We frequently author and lecture on estate planning topics to lawyers. To illustrate the evolving nature of our thinking in regard to authorizing gifts under DPOAs, here are a few examples of our recent writings, in which we explain that the DPOA should contemplate the strategy about which we are speaking:

> Richard S. Franklin, *Lifetime QTIPS - Why They Should be Ubiquitous in Estate Planning,* 50 U. Miami Heckerling Institute on Estate Planning ¶ 16 (University of Miami, Lexis Nexis, June 2016):

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[6] Note: While deathbed gifts will avoid the Maryland estate tax, gifts made in contemplation of the decedent's death will not avoid the Maryland inheritance tax. (Yes, Maryland has both an estate tax and an inheritance tax.) Maryland imposes a separate inheritance tax on the receipt of property from a Maryland decedent by individuals who are not of a specified relation to the decedent. The Maryland inheritance tax is 10% of the date of death value (or date of gift as applied to gifts made in contemplation of death) of the assets received by such beneficiary from the decedent. Close relatives, including grandparents, parents, spouses, descendants, spouses of descendants, and siblings are exempt from the inheritance tax, so property passing to the surviving spouse and the decedent's descendants would not be subject to Maryland inheritance tax.

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> *"Consider ensuring that the spouse in any QTIP trust can release all or any portion of his or her life interest. Such a release would enable the donee spouse to trigger a gift for gift tax purposes, which may be beneficial to achieve transfer tax savings. For example, the spouse may be domiciled in a jurisdiction that imposes a state estate tax but no state gift tax. Being able to trigger a gift prior to the spouse's death with respect to the value of the QTIP could avoid state estate taxes (of course there are a host of issues to consider in implementing this gift strategy, including the lack of an automatic basis adjustment for income tax purposes under section 1014 with a gift). [Footnote:* ***Also ensure that the spouse's durable power of attorney permits the agent to execute releases over trust interests for purposes of triggering gifts.*** *] Frequently, the QTIP trust will constitute the principal asset available to the spouse for purposes of making gifts."* [Emphasis added.]

Richard S. Franklin & Lester B. Law, Never Pay Estate Taxes - The Annual Taxable Gift Approach with a CLAT Remainder, 46th Annual Estate Planning Seminar, Estate Planning Council of Portland, Oregon (January 20, 2017):

> *"To allow the ATGs [annual taxable gifts] Approach to continue in the event of the G1's incapacity****, ensure that the G1s' durable powers of attorney allow the agent to continue using the ATGs Approach to fund the IGTs [irrevocable grantor trusts****]. This means that expansive authority to make gifts should be granted -- i.e., to make taxable gifts that generate gift tax liability. Therefore, this is going a step beyond the simple authority to make annual exclusion gifts and even beyond the authority to use the applicable exclusion amount. Also authorize the agent to file gift tax returns, consent to split-gifts with a spouse, and pay the applicable gift taxes (and interest and penalties). Moreover, it may be helpful to authorize the agent to create IGTs into which the annual taxable gifts could be made."* [Emphasis added.]

Richard S. Franklin & George D. Karibjanian, *An Oxymoron? The Deathbed Lifetime QTIP for Basis Adjustment and Asset Protection,* Vol. 41, No. 6 of BNA/Tax Management's Estates, Gifts & Trusts Journal 219 (November 10, 2016):

> *"In effect, the exercise provisions would be analogous to disclaimer provisions – i.e., they remain dormant unless the spouse who would be the surviving spouse decides to execute the plan. In addition, depending on the applicable state law,* ***the revocable trust should allow an agent under a durable power of attorney to implement the Release and the settlor's durable power of attorney should authorize the agent to implement such Releases.*** *Notwithstanding the provisions under applicable state law regarding the formalities of executing documents relating to testamentary dispositions, it is highly recommended that, at a minimum, the Release be notarized. Since notarizations require the insertion of the date of notarization, the notarial clause can act as a validation that the Release was executed prior to the death of the donee spouse.* [Emphasis added.]

The tax and estate planning landscape changes constantly, which requires adjustments to the gift-authorization provisions. As explained in our prior Client Alert titled Trump the Estate Tax, there is a possibility that the gift/estate tax may be repealed (of course such taxes, if repealed, may be later reinstated). We noted that families may wish to quickly move assets into irrevocable trusts if the gift tax is repealed. The goal of this planning would be to grandfather assets from any subsequent reinstatement of the estate tax, as well as furthering non-tax goals. Therefore, we suggested that

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DPOAs be updated to authorize the Agent to implement such a plan of action during any periods of incapacity.

A note of caution is warranted. The DPOA is a very powerful instrument, because, by its terms, it allows the Agent to act on the Principal's behalf with respect to all of the Principal's personal assets. Out of concern for such sweeping powers, conventional wisdom is to limit the Agent's powers. However, we believe that carefully selecting an Agent whom the Principal fully trusts is the preferred way to mitigate the risks associated with granting broad powers, including gift-giving powers. It is, after all, the broad powers that allow for achieving better results.

The DPOA imposes a high standard for the Agent. Specifically, the Agent must always act in the Principal's best interests[7]. The Agent must also avoid conflicts of interest in the exercise of the powers granted. Gifts that jeopardize the Principal's financial security would not be appropriate under any circumstances. Additionally, when making gifts, the Agent must carefully consider numerous income, gift and estate tax consequences, as well as property law concerns. Obtaining adequate advice prior to actually implementing any gifts is critical.

Of course, DPOAs authorize the Agent to take many more actions other than just making gifts. For example, in our prior Client Alert titled, Granting Authority Over Your Digital Communications, we outlined the considerations in granting your Agent authority over your digital assets and communications. This is an evolving area of law and importance as more and more aspects of our lives reside in the digital realm, and it's another reason why we might recommend updating an existing DPOA.

Typically, DPOAs are treated as "form" documents, but as evident from the discussion above, we carefully consider the provisions of these instruments. This reflects our goal of positioning our clients to achieve good results, even during periods of incapacity.

If you have any questions about your DPOA, please call one of our lawyers.

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[7] *See* Matter of Dietz, 2015 WL 1312187, 2015 NY Slip Op. 50359(U) (NY Surr. 2015).

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