

M INTELLIGENCE

PLANNING FOR REDUCED LIFE EXPECTANCIES WHEN TIME IS SHORT, BUT FINAL WISHES ARE NOT

News that death is nearer than expected may make one feel powerless, but it's still possible to take back control financially and prepare to pass on wealth and protect loved ones.

Benjamin Franklin's pithy observation that "You may delay, but time will not," takes on new meaning when an individual faces deteriorating health or a prognosis of a shortened lifespan. An ill or terminally-ill client needs to take Ben's wisdom to heart and act. If they have end-of-life directives and wealth and estate planning that is in place, they need to ensure that their wishes are still current. If they don't, they need to put them in place.

UNDERSTANDING THE TIMELINE

What is helpful is to understand one's medical and family history early on to allow more time for planning. So, for instance, if a short lifespan runs in the family, plan for the possible, and hope for the best.

If a specific illness has been diagnosed, have medical professionals determined a shortened lifespan? If so, have they offered a professional opinion on the approximate remaining life expectancy (e.g., less

than five years, less than three years, six months, or unspecified). It's important to note that the definition of "terminally ill" varies widely. In an IRS publication detailing guidelines for the distribution of individual retirement accounts, terminally ill is defined as the expectation of death in 84 months or less.¹ Medicare defines terminally ill more narrowly at just six months or less.²

COLLECT YOURSELF, ACT, AND COMMUNICATE

Allow yourself time to react (or not if you're still in shock). When ready, **act**, and then **communicate**.

Importantly, what action an individual takes is prescribed by their life expectancy, and their health and mental competency.

1 IRS 2023 Publication 590B—Distributions from Individual Retirement Arrangements (IRAs), p. 25 of 59—March 12, 2024

2 Medicare Benefit Policy Manual, Chapter 9, Coverage of Hospice Services Under Hospital Insurance, p. 4 of 62

ACT

It is essential to establish a health care proxy, power of attorney, and funeral directives for immediate needs, and a will and estate plan to facilitate the transition of wealth after a terminally ill individual dies. If a will and estate plan already exist, it is important to affirm that those plans still meet the individual's needs and that earlier strategies are still effective. If plans were made quite a while ago, they may need to be reviewed and altered to reflect new legislation and regulation, new IRS directives, new products iterations, and new strategies. They may also need to be reviewed to ensure that beneficiaries are still living or are existing charities, and are still people or entities that the ill individual cares about. It is also important to confirm that roles such as executor, guardian, and trustee remain good choices.

COMMUNICATE

Once the individual has decided what their wishes are, they will need to communicate with whoever is selected to hold health care proxy powers, trusteeship, executorship, and the power of attorney. A more encompassing communication effort with family and close friends should follow shortly after to let them know about the individual's health status and to give them time to process and react if needed. It might be worth scheduling a full day or weekend to first address the emotional component of such news, and then address the business of preparing to pass the ill individual's wealth. This opportunity could include an estate planning professional and might cover the rationale behind passing along assets, a review of the mechanics of transitioning assets, pertinent information on important documents and where they are kept, and a time to answer questions. It might also be an opportune time to measure reaction and have private conversations with specific family members if they are disappointed with the ill individual's decisions.

ADVANCED CARE PLANNING

There is a whole nuanced vocabulary around the advanced care planning process, so it is important to understand what each term means.

- **Advance medical directive** is an umbrella term used both to detail how one wants to live and also to describe state-approved advance medical directive documents which specify the preferred details of care in the event of a medical event. Advanced medical directives usually appoint a trusted individual as a surrogate or health care agent to speak for you when you are not able to do so.³
- **Portable Medical Orders** (Physician Orders for Life Sustaining Treatment or POLSTs) are different than an advanced medical directive because they are usually used for individuals who are seriously ill or frail and state specific medical wishes which have the effect of medical orders. They must be filled out and signed by a medical provider and do not name someone to act on the individual's behalf. Emergency medical technicians must honor a POLST unlike an advanced medical directive or medical powers of attorney which do not have the same force. After an individual is treated by a physician who conducts a medical evaluation, then advanced directives can be implemented. POLSTs specify types of treatment such as feeding tubes and mechanical ventilation. They can, but do not have to, include a "Do Not Resuscitate" (DNR) order.⁴
- **DNRs** are medical orders written by a doctor which state that cardiopulmonary resuscitation (CPR) should not be performed if breathing stops or the heart stops beating.
- **Living wills** are documents that specify an individual's preferences for medical care in the event that person can't make their own decisions.
- **Health care proxies** are documents that empower trusted individuals (also called health care agents, surrogates, or representatives) to make health care decisions together with health care professionals if the party that creates the health care proxy can't make medical decisions for themselves.

3 CaringInfo.org, <https://www.caringinfo.org/planning/advance-directives/what-is-an-advance-directive/>

4 CaringInfo.org, <https://www.caringinfo.org/planning/advance-directives/polsts-are-portable-medical-orders/#:::text=POLST%20is%20for%20people%20who,signed%20by%20health%20care%20provider.>

WEALTH PROTECTION AND TRANSFER

A successful wealth protection and asset transfer plan uses tools such as power of attorney and a will to complete a well-conceived estate planning strategy.

POWER OF ATTORNEY (POA)⁵

This legal document authorizes a trusted person to act as the agent or attorney-in-fact for an individual, referred to as the principal. If you have a durable power of attorney, it will continue to be in effect even when the principal becomes incapacitated.

The powers awarded can be extensive and include the right to access bank accounts and to make decisions for you. A short-term POA, which often grants limited authority, is also an option.

Medical decision-making can be part of a durable POA and can be addressed through a separate health care proxy noted earlier which appoints a health care surrogate.

It's important to understand specific state strictures. For instance, some states allow for "springing" durable powers that are triggered by incapacitation and other states recognize those powers immediately. It's also important to note that once incapacitation occurs, it might be too late to put a POA in place. For instance, if dementia is diagnosed, an attorney is legally and ethically prevented from establishing a POA. Failure to put a POA in place may result in the need to go to court and apply for a guardianship or conservatorship. For an individual with a limited lifespan, this may not be possible. Even if it is, it can be expensive, time consuming, and potentially challenged.

WILLS

A will is like GPS for an estate — it puts the executor on course to distribute wealth according to an individual's wishes. That is why it is so important to create a will and update it regularly. Updates provide the most accurate assessment of needs and wishes, reflecting life events including births, deaths, marriages, and divorces. A codicil is an addition to the will that enables a testator of a will or a settlor

of a trust to alter a will without having to completely rewrite it. If a terminally ill person has children who are minors, the document becomes even more important as wishes and instructions are expressed to protect their most precious asset — their offspring.

If a will is not in place, an individual will die intestate, and the discretion to disperse assets and protect loved ones is taken from the deceased and replaced by state law which varies by state.

Whether a will can be created after the diagnosis of a terminal illness prior to death depends on circumstances. If someone is too ill to sign legal documents, or they have an illness such as dementia where they lack the requisite mental or testamentary capacity, creating a will won't be possible. If they are mentally sound and want to create a will, it will be feasible. However, legal documents including a will that are created when an individual is ill or dying stand a greater chance of being contested.

Other retirement accounts: Review beneficiaries on bank accounts, life insurance policies, retirement accounts, and annuities.

LIFE INSURANCE

Firstly, it's **essential to continue to pay premiums on any life insurance policies so that they don't lapse.**

With this important housekeeping item in hand, it's helpful to know how the life insurance death benefit is treated for estate tax purposes. If the ill individual is the insured and owns the policy, the death benefit is included in their estate even if a beneficiary receives the death benefit proceeds. However, if the policy is owned by an irrevocable life insurance trust (ILIT) or is included in another type of trust, inclusion in the insured's estate can be avoided. The ILIT owns and is beneficiary of the policy(ies), and its trustee manages the trust's assets for the benefit of the trust's beneficiaries.

5 "Powers of Attorney: Crucial Documents for Caregiving," by Amanda Singleton, AARP, Dec. 10, 2021; and Consumer Financial Protection Bureau, "What is a Power of Attorney (POA)?", Last reviewed Jan. 29, 2024.

Caveat: If the policy(ies) have already been transferred, they must be in the trust over three years to avoid proceeds being included in the insured's estate. If the trust and policy transfer still need to be created and executed, then this strategy may not work if the life expectancy is around three years or less. The purchase of the policy by the trust would eliminate the three-year look back. If the policy(ies) are gifted, that gift may also reduce the insured's lifetime exemption.

Once the fundamental tools are in place, a review of the estate plan and any final options can occur in preparation for an individual's death and transfer of assets. If there is no estate plan and the ill individual is competent, and has a sufficient projected lifespan, it may be possible to put a plan in place.

FEDERAL ESTATE TAXES

A starting place is for the terminally-ill individual or their representative to understand how the federal estate tax exemption works and to what extent it will benefit their estate. In 2024, the lifetime gift and estate tax exemption as established by the Tax Cuts and Jobs Act (TCJA) of 2017 is \$13.61 million (\$27.2 million per married couple). Any combination of gifts or estate that exceeds that amount is subject to a 40% estate tax rate. However the TCJA and its provisions sunset after December 31, 2025 unless Congress extends it and the president signs it into law. Currently, if a seriously or terminally-ill individual dies in 2026, the total exemption will revert to pre-TCJA levels of \$5.6 million adjusted for inflation.

GIFTING

In preparation for that possibility, an ill individual may want to estimate how much they have already gifted, and how much they can still gift (in 2024, annual gifts of \$18,000 per donee can be made; \$36,000 if there is a marital gift split). Additionally, that individual can use the unlimited marital deduction to pass along assets to the well spouse. However, that strategy may be postponing the inevitable — an estate tax bill that comes due when the well spouse dies. There are different limits for non-U.S. spouses (see M's *U.S. Gift & Estate Tax 2024 Exemptions and Deductions*).

Caveat: When gifting is being considered, it's best to make gifts only if state or federal estate taxes are likely to be imposed because the donee takes the donor's basis for tax purposes. Because of this it is also better to use high-basis assets when possible unless it is a specific asset such as closely held business that may be sold in the near future.

However, if the estate is not subject to estate taxes because it will not exceed the federal limit, then it may be best to let assets remain in the estate and take a step-up in basis at the death of a terminally-ill individual. If the asset's basis is higher than fair market value, then it may be preferable to sell it, recognize the loss and avoid a step-down in basis.

Caveat: An ill individual should gift as early in the year as possible, and if made by check, the donee should deposit it quickly and before the donor's death to ensure the gift is removed from the donor's estate. If the donor pays the gift tax, those amounts will reduce the estate, and possibly the estate tax obligation. If the donor survives for more than three years, after making the gift, the gift tax payment is not subject to estate taxes. And, in certain cases, some states which levy estate taxes do not account for gifts particularly if the donor lives for over three years after making the gift.

STATE ESTATE TAXES

An ill individual should make sure that their state's estate tax exemption, if any, is exhausted. Unused federal exemptions can be used by a surviving spouse, but most states don't allow exemptions to be passed along to the surviving spouse.

STRUCTURING AND TITLING OF ASSETS

Assets can be structured to minimize capital gains and realize substantial savings for heirs. For instance, it may be possible for the ill individual to own low-basis assets gifted by a spouse. In general, gifts between spouses are usually not taxable. When the ill individual dies, those assets could receive a step up if they have appreciated. Similarly, an ill individual who is the settlor in an irrevocable grantor trust, may be able to swap in high-basis assets and swap out low-basis assets into their estate if the trust permits.

IN CONCLUSION

An end of life medical diagnosis can produce many emotions, but regret doesn't have to be one of them. Although specific to each individual's situation, it may well be possible to review or create a final plan to ensure that one's wishes are carried out and loved ones are financially protected.

This article is meant to provide some basic considerations for any individual or family of an individual facing a terminal illness. However, as there are many nuances and complexities to estate planning, it is best to work with a seasoned professional to ensure an optimal outcome.

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