Tennessee's creative solution:

Estate Planning After Incompetence

By Dan W. Holbrook

"Set your affairs in order, for you are going to die."

— 2 Kings 20:1

"I'm not afraid to die; I just don't want to be there when it happens."

— Woody Allen

Estate planning attorneys are painfully aware that too many people procrastinate in writing wills and otherwise "setting their affairs in order." When a client becomes incompetent and unable to execute documents, it may seem too late to do any effective planning. However, two new developments in Tennessee law have created some amazing possibilities until recently unthinkable.

First, a new statute[1] codifies and clarifies the ability of an agent to use a power of attorney to make gifts. Second, the Court of Appeals, in a recent unpublished opinion[2], has taken such an expansive view of the new statute that it can be used to accomplish a great deal of comprehensive estate planning, when the client has failed to plan for himself before becoming incompetent.

1. History of the statute

Agents under a general power of attorney often make gifts after the principal becomes incompetent, because gifts can be highly useful. For example, gifts can reduce the principal's taxable estate for death tax purposes,[3] and gifts can continue the principal's pattern of giving to his church or other charitable causes. Unfortunately, many general powers of attorney do not explicitly grant a power to make gifts.[4] In such event, the scope of the agent's powers under the common law has not been well defined.[5]

The IRS has consistently maintained that no gift is valid under a general power of attorney unless it is explicitly authorized by the document or by state law. The Tennessee Department of Revenue, in turn, has consistently maintained that Tennessee law would not permit an agent to make any gifts unless explicitly authorized in the power of attorney. This is important because if the department is correct, then any gifts made through the exercise of a general power of attorney are incomplete gifts, revocable by the principal if he became competent again, and are not removed from the principal's taxable estate at his death. The department's position, which is a question not of tax law but of state property law, has never been litigated in an appellate decision in Tennessee.

In response to this uncertainty, a statute was enacted in 1997 to settle and codify Tennessee law. It originated with the Tennessee Probate Study Committee,[6] who wished not only to clarify the law but also to codify what they believed the law in Tennessee to be anyway, in the absence of any

clear precedents. Accordingly, the statute specifically provides that it is declarative of existing law,[7] a provision that provides ammunition for those attorneys defending against the Department of Revenue. But to understand the statute, and especially to understand why it is declarative of existing law, it is first important to see it in the context of the history of "substituted judgment."

2. The common law doctrine of "substituted judgment"

It is well-settled that courts, applying the principle that an incompetent's estate is liable for the support and maintenance of the ward's family, may authorize guardians and conservators to make gifts on behalf of their wards to the ward's immediate relatives.[8] In addition, where there is no legal obligation to support, courts often apply the doctrine to determine what provision the incompetent himself would have made if competent.[9] Many courts have relied on the doctrine to allow gifts to effectuate sound estate planning, including carrying out the incompetent's expressed wishes and minimizing death taxes.[10] Courts also allow gifts to charity when the evidence establishes that the proposed charitable gift is for a charity to which the incompetent himself would have contributed had he been competent.[11]

3. Tennessee's first codification of "substituted judgment": Conservatorships

In 1992, Tennessee codified the "substituted judgment" doctrine in the area of conservatorships, in *Tenn. Code Ann.* §34-11-122, "Distributions to persons other than minor — gift program." It allows a court to authorize gifts by guardians and conservators if such gifts are in the disabled person's best interests:

In considering expenditures of income or principal of the minor's or disabled person's property, the court may authorize distributions to persons other than the minor or disabled person if the court determines the expenditures are in the best interests of the minor or disabled person. In making its decision, the court may consider whatever information the court deems relevant to its decision, keeping in mind its primary responsibility is for the care and maintenance of the minor or disabled person and the person's property. No gift program shall be authorized unless there is evidence the disabled person established a gift program prior to becoming a disabled person or, even though the disabled person had not established a gift program, a gift program would reduce the disabled person's tax liability and would not jeopardize the disabled person's care and long-term well-being.

No Tennessee cases have cited this statute. Either practitioners have ignored the statute, or more likely, the statute has been used successfully, without need of appellate review. What is striking is the broad scope of authority granted to a court to make gifts on behalf of the incompetent ward. Not only can a court order that gifts be made for the support of family members, but gifts may be made for purely tax reasons. This is so even though the incompetent ward has no history of making gifts, has never expressed any desire to make gifts, and did not even select the person who is serving as conservator. This is clearly far broader than the mere common law doctrine of "substituted judgment" would suggest.

What was missing was a codification of giftmaking powers in the context of powers of attorney.

4. Tennessee's second codification of "substituted judgment": General Powers of Attorney

Filling the void, and precipitated by the narrow position of the Tennessee Department of Revenue, the Tennessee legislature in 1997 enacted Tennessee Code §34-6-110, "Gifts under power of

attorney."

The statute is in two parts. Under subsection(a), if the principal gives the attorney-in-fact broad powers, *i.e.,* the power is a general power, and if the principal has a history of making gifts, the attorney-in-fact may continue to make gifts in accordance with that history:

(a) If any power of attorney or other writing: (1) Authorizes an attorney-in-fact or other agent to do, execute or perform any act that the principal might or could do; or (2) Evidences the principal's intent to give the attorney-in-fact or agent full power to handle the principal's affairs or to deal with the principal's property; then the attorney-in-fact or agent shall have the power and authority to make gifts, in any amount, of any of the principal's property, to any individuals, or to organizations described in §§170(c) and 2522(a) of the Internal Revenue Code or corresponding future provisions of the federal tax law, or both, in accordance with the principal's personal history of making or joining in the making of lifetime gifts. This section shall not in any way limit the right or power of any principal, by express words in the power of attorney or other writing, to authorize, or limit the authority of, any attorney-in-fact or other agent to make gifts of the principal's property.

Subsection (b) allows a court to authorize the attorney-in-fact to make gifts even if the power granted does not explicitly authorize gifts and even if there is no history of gift-giving:

(b) If the provisions of subsection (a) do not apply, an attorney-in-fact or other agent acting under a durable general power of attorney or other writing may petition a court of the principal's domicile for authority to make gifts of the principal's property to the extent not inconsistent with the express terms of the power of attorney or other writing. The court shall determine the amounts, recipients and proportions of any gifts of the principal's property after considering all relevant factors including, without limitation:

(1) The value and nature of the assets of the principal's estate;

(2) The principal's foreseeable obligations and maintenance needs;

(3) The principal's existing estate plan; and

(4) The gift and estate tax effects of the gifts.

Subsection (c) of the statute states that it declares existing law.

Virginia was the first and only other state to enact a statute like Tennessee's with regard to gifts under a power of attorney.[12] It was enacted in 1992 and is substantially similar to the Tennessee statute, including the statement that it is declaratory of existing law.

The Virginia statute was construed by the Fourth Circuit Court of Appeals in 1994.[13] The court held that the principal's history of tax-conscious gifts plus the broad language in the power of attorney showed the principal's intent to grant to the attorney-in-fact the power to continue making gifts. The court said of the statute:

In enacting the gift statute, the General Assembly likewise incorporated the presumed intent of principals to permit their attorneys-in-fact to make gifts pursuant to the broad, general powers expressly provided …[14] [T]he statute also looks to intent by examining the entire instrument and surrounding circumstances. The statute merely clarifies that a court may infer a gift power when

one is not explicitly set forth.[15]

Although the statutes are quite similar, the Virginia statute, unlike the Tennessee statute, does not so clearly allow gifts when there is no history of gifts. Subsection C of the Virginia statute says that the court should take into account the principal's gift history, while Subsection (b) of the Tennessee statute applies even if there is no gift history at all. The Fourth Circuit interpreted the Virginia statute to say that a court should seek the principal's intent by examining the entire instrument and surrounding circumstances. A Tennessee court would certainly do the same, but in Tennessee no prior history of gifts is necessary for a court to conclude that gifts should be authorized.

What was still missing was a judicial construction of the extent of powers actually granted under the Tennessee statute. Could a court authorize large gifts, even in the absence of a history of making gifts? Could a court authorize gifts that were meeting not just lifetime objectives but that were in effect testamentary substitutes? The answers came quickly, and the answers were not only yes, but hell yes.

5. The Grubb case: Gifts are good

Mr. John Grubb, a successful businessman in Monroe County, Tenn., was 83 years old, unmarried, and had no children. His estate was estimated to be in the range of $1 million to $2 million. His only heir was his sister, age 85, who was incapacitated, under a conservatorship, and incapable of executing any legal documents. He had no specific history of making gifts, charitable or otherwise.

On Oct. 10, 1997, Mr. Grubb executed a document labeled "Unlimited Durable Power of Attorney," granting broad powers to a trusted, unrelated friend and former employee. It was a general power, containing this statement: "This Power of Attorney is a full Power of Attorney and not limited in any manner whatsoever." It did not incorporate the Tennessee statutory powers by reference, but it did list in summary form some very broad powers, including an omnibus power " … to do any and everything necessary to effectuate the purpose of the Power of Attorney as fully as I could in person … "

On or about Aug. 21, 1998, Mr. Grubb expressed his desires about writing a new will to his agent, and the agent consulted with an attorney about writing the will. His first concern was to provide for his sister, then to make some relatively small specific bequests, and finally to put the residue of his estate to good use for the benefit of Monroe County. Unfortunately, before the will could be drafted, Mr. Grubb suffered a permanently debilitating stroke.

Mr. Grubb's agent under the power of attorney quickly filed a petition in the Chancery Court of Monroe County to authorize the making of gifts consistent with Mr. Grubb's explicitly stated desires. Specifically, the petition requested that certain small gifts be made, and that the excess of Mr. Grubb's estate over $625,000 be given to a community foundation for the use and benefit of the citizens of Monroe County. That would leave $625,000 in Mr. Grubb's name, available for his use and benefit for the rest of his life, managed under the power of attorney. Under both federal and state death tax laws, that amount would be able to pass tax-free at his death, his sister being his sole heir in the absence of a will, or if she predeceased him, his estate would pass to his heirs at law.

A hearing was held on Sept. 8, 1998. The chancellor heard testimony from the guardian ad litem, the attorney-in-fact, and others as to Mr. Grubb's assets, the trusted relationship with his agent, his expressed testamentary desires, his life expectancy, his foreseeable needs and obligations as a permanently disabled resident of a nursing home, the estate tax savings from the proposed gifts,

and the history, scope, and intent of the new statute.

The next day, Sept. 9, 1998, the chancellor ruled that the statute did not authorize the gifting of the bulk of Mr. Grubb's estate to charity:

The wording of the Power of Attorney does not rise to the level necessary for this Court to find that the Principal, John D. Grubb, intended to donate the bulk of his estate to the East Tennessee Foundation and to allow such would be inconsistent with the Durable Power of Attorney which appears to have been created for the purpose of marshaling assets and paying bills of John D. Grubb. Therefore while the goals of saving tax dollars are appropriate in estate planning, this Court does not feel the statute is intended to allow attorneys-in-fact to do something so divergent from what the principal has done in the past. With this proof this Court cannot make decisions concerning the value and nature of the assets of the Principal's estate and the Principal's foreseeable obligations and authorize a permanent divestiture of assets of the Principal.[16]

The order was appealed, under an expedited procedure. On Nov. 2, 1998, the Court of Appeals issued a unanimous decision reversing the chancellor. It ordered, without remand to the chancellor for any action other than entering the order, that all of the gifts requested in the original petition be granted immediately. Surprisingly, it went one step further, providing relief not even requested in the original petition. It ordered that the assets remaining after the gifts, namely $625,000, be gifted as well, to a trust for the benefit of Mr. Grubb for life, then for the benefit of his sister for life if she survived him, and finally the remainder to the community foundation for the benefit of Monroe County. This last result is surprising, to say the least.

It is one thing to declare, where there is no prior history of gifts, that the statute can be used to authorize significant gifts, at least where there is clear evidence of the principal's desires, as in this case. This is an expansive view of the statute, but one that is consistent with and fairly explicit within the language of the statute itself, and that serves the purposes of the parties well in this or any similar fact situation. In fact, this is a reasonable extension of the statutory authority granted years ago to conservators to obtain court order for gifts. If a conservator can obtain an order to make a gift, then an agent under a power of attorney should have at least as much authority, especially since the agent is hand-picked by the principal. Further, there is no reason why the gift could not be large, if it serves the principal's tax and nontax purposes and the principal remains financially secure.

It is altogether another thing, however, to declare that the statute can be utilized in effect to rewrite a person's will, *i.e.,* to serve as a will substitute. This is more than expansive, it is a liberal, indeed activist approach to the statute. Nevertheless, it is now the law of the land — at least until the issue reaches the state Supreme Court, if ever.

7. Conclusion: Celebrate the creation of a new estate planning tool

The new statute allowing courts to authorize gifts under a power of attorney even in the absence of a history of giving has clearly been warmly received by the Tennessee Court of Appeals. This development opens up opportunities for accomplishing estate planning in situations otherwise considered hopeless. In the right fact situation, the Court of Appeals interpretation leads to an excellent result. Without the court's creation of a trust as a will substitute, the $625,000 balance of Mr. Grubb's estate would likely have ended up in the hands of remote heirs whom the evidence showed Mr. Grubb did not wish to benefit. Instead, Monroe County will be blessed with a sizable charitable endowment.

But what if the intent of the principal had not been so clear? Can chancellors always adequately cope with a statute which, in light of the Court of Appeals interpretation, seems virtually unlimited in the discretion allowable? The cautious approach of the chancellor in this case was commendable at least for putting the needs of the principal above all else, including taxes. The Grubb case has unleashed a dangerous force to contend with, or else created a flexible solution to otherwise hopeless problems … or both. Until any limits are imposed by appellate reconsideration or statutory amendment, however, Tennessee estate planners should rejoice at having a shiny new weapon in their arsenal, available in no other state, that can accomplish both personal planning and tax savings for incapacitated clients.

Endnotes

1. *Tenn. Code Ann.* §34-6-110, enacted effective June 1, 1997.

2. *In Re: John D. Grubb* (C.A. No. 03A01-9809-CH-00297)(1998). John W. Cleveland, Esq., of Sweetwater, Tenn., attorney for Mr. Grubb.

3. Gifts to individuals up to $10,000 per person per year are excluded from the federal gift tax (Internal Revenue Code §2503(b)) and also from the Tennessee gift tax in the case of "Class A" beneficiaries (*Tenn. Code Ann. §*67-8-104).

4. For example, the incorporation by reference of certain statutory powers, without any other language of authorization, is explicitly stated *not* to authorize the making of gifts. *Tenn. Code Ann.* §34-6-109.

5. For an excellent summary and survey of the law of all the states in these matters, see Randall D. Van Dolson and G. Warren Whitaker, "Gifts by Agents Under Durable Powers of Attorney," *Probate and Property* (Sept/Oct 1995).

6. The Tennessee Probate Study Committee is a joint committee of the Tennessee Bar Association and the American College of Trust and Estate Counsel, chaired by Albert W. Secor, Esq., of Chattanooga. Since 1985, this committee has actively reviewed state laws and is responsible for many improvements in the laws of inheritance, property, and tax affecting estates and trusts in Tennessee.

7. *Tenn. Code Ann.* §34-6-110(c).

8. *See* "Power of Court or Guardian to Make Noncharitable Gifts or Allowances Out of Funds of Incompetent Ward," 24 A.L.R. 863 §2, and cases cited therein; *see also In re Kenan*, 261 N.C. 1, 134 S.E.2d 85 (1964) for a discussion of the English common law doctrine; and *Tate v. Tate*, 190 Tenn. 39, 227 S.W.2d 50 (1950), for a brief discussion of the history of the doctrine and its original codification in Tennessee.

9. 24 A.L.R. 863 §2, supra.

10. *See Id.*, §16[a], and cases cited therein.

11. *See* "Power to Make Charitable Gifts From Estate of Incompetent," 99 A.L.R. 946, and cases cited therein; *In re Kenan*, 261 N.C. 1, 134 S.E.2d 85 (1964); 262 N.C. 627, 138 S.E.2d 547 (1964) (appeal after remand).

12. *Virginia Code Annotated* §11-9.5, "Gifts under power of attorney," reads as follows:

A. If any power of attorney or other writing (i) authorizes an attorney-in-fact or other agent to do, execute, or perform any act that the principal might or could do or (ii) evidences the principal's intent to give the attorney-in-fact or agent full power to handle the principal's affairs or deal with the principal's property, the attorney-in-fact or agent shall have the power and authority to make gifts in any amount of any of the principal's property to any individuals or to organizations described in §§170(c) and 2522(a) of the Internal Revenue Code or corresponding future provisions of federal tax law, or both, in accordance with the principal's personal history of making or joining in the making of lifetime gifts.

B. Subsection A shall not in any way impair the right or power of any principal, by express words in the power of attorney or other writing, to authorize, or limit the authority of, any attorney-in-fact or other agent to make gifts of the principal's property.

C. After reasonable notice to the principal, an attorney-in-fact or other agent acting under a durable general power of attorney or other writing may petition the circuit court for authority to make gifts of the principal's property to the extent not inconsistent with the express terms of the power of attorney or other writing. The court shall determine the amounts, recipients and

proportions of any gifts of the principal's property after considering all relevant factors including, without limitation, (i) the size of the principal's estate, (ii) the principal's foreseeable obligations and maintenance needs, (iii) the principal's personal history of making, or joining in the making of, lifetime gifts, (iv) the principal's estate plan, and (v) the tax effects of the gifts.

13. *Estate of Ridenour v. Comm'r*, 36 F.3d 332 (4th Cir. 1994).

14. *Id.* at 336.

15. *Id.* at 335.

16. *In Re: John D. Grubb*, Chancery Court for Monroe County, Tennessee, No. 12,463.

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